

ANNUAL REPORT 2011



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Ceapro Inc. is a Canadian biotechnology company involved in the development of proprietary extraction technology and the application of this technology to the production of extracts and "active ingredients" from oats and other renewable plant resources. Ceapro adds further value to its extracts by supporting their use in cosmeceutical, nutraceutical, and therapeutics products for humans and animals.

III LETTER TO SHAREHOLDERS

Dear Fellow Shareholders

2011 has been another exciting year since Ceapro's inception. Record revenues, record margins and record net profits were achieved despite a very challenging economical context especially in Europe where we derived 22% of our revenues.

In spite of this challenging economical context prevailing in 2011, we remained focused on our objectives and maintained our commitment to quality science having significantly increased our investments by 29% in Research and Development.

Our team of dedicated people deployed tremendous efforts to complete the transformation of your Company to a fully integrated biotechnology company with a full spectrum of activities ranging from "Field to Formulator", an expression that you will hear a lot from Ceapro in the future.

We are very proud of the following key accomplishments that will have certainly set the stage for value creation in 2012 and beyond:

Financials:

- Record sales of \$5,786,000 in 2011 compared to \$5,577,000 in 2010.
- Gross margin increase of \$731,000 representing an improvement of 29% over 2010.
- Income from operations of \$585,000 in 2011 compared to \$191,000 in 2010.
- Net profit of \$578,000 in 2011 compared to a net profit of \$464,000 in 2010 which included the recovery of a non-operational legal cost of \$315,000.
- Significant balance sheet improvement resulting from major debt reduction, improvement of cash position and return to shareholders' positive equity.

Operations:

- Successful completion of manufacturing audit by a multi-national company raising Ceapro status to top level rating and receiving a preferred supplier status with them.
- Successful scale up of a novel drying technology from lab scale unit to pilot scale.
- Successful second year propagation of spearmint crop and expansion to private farms showing extremely high levels of target active ingredients.
- Successful performance testing showing the superior hair colour fastness benefits of newly launched Ceapro's CP Sweet Blue Lupin Peptide, opening this large market segment to Ceapro.
- Announcement of successful Development and Commercialization funding application with Innovation PEI and collaboration agreement with the National Research Council to develop commercial products from a unique variety of rosehips.
- Completion of an exclusive license and distribution agreement with Ross Organics for the sales of Ceapro's "All Natural" active ingredients in the Western USA.
- Amendment of University of Guelph licensing agreement for spearmint to allow for all fields of use, including food and tea applications.
- Major grant of \$1.6 million approved with \$750,000 received to date from Alberta Innovates Bio Solutions for the acquisition of capital equipment for a new manufacturing facility.

- Subsequent to year end, Ceapro successfully negotiated a license with Agriculture and Agri-Food Canada which provides sole worldwide rights for a process technology for potential applications with our flagship product, avenanthramides in all fields of use.

In summary, 2011 operating results are the best ever in Ceapro's history with a corresponding improvement in our financial position, and a return to positive shareholders' equity. Ceapro is amongst one of the very few Canadian biotech companies to have recorded a net profit in 2011, and we have demonstrated a track record of growing and sustainable operations for the last several years. This was achieved notwithstanding our commitment to significantly increase investments in Research and Development to support commercialization of new products and technologies. Our customers, collaboration partners, and governments recognize the value of Ceapro's innovative products and technology, which covers the whole spectrum of our business "From Field to Formulator".

Ceapro's team has delivered in 2011. Looking forward, we expect Ceapro to grow sales in 2012 while pursuing the development of key projects like the development of a second generation of avenanthramides, the advancement of the spearmint project and the completion of the supercritical fluid drying technology platform which might be applicable to certain Ceapro water soluble products.

We also expect to continue to build on the capability to market our products better and with enhanced representation around the globe. New distributors will continue to be added in 2012 to reach a worldwide audience and Ceapro intends to complete a thorough marketing analysis in Q2 2012 with the assistance of a third party firm to identify, build, and support the infrastructure needed to market Ceapro products globally. This will be a comprehensive process and we anticipate we will make significant marketing investments in 2012.

Our small group of employees has bought into these challenges and we wish to thank everyone for their efforts in striving to make Ceapro one of the best biotech companies in Canada.

Finally, we would like to thank our customers and our shareholders for their support and confidence.

GILLES R. GAGNON, M.SC., MBA
DIRECTOR AND ACTING CEO

ED TAYLOR, CGA
CHAIRMAN OF THE BOARD

May 25, 2012

WORLD-CLASS INNOVATION

AVENANTHRAMIDES - THE NEXT BIG OAT STORY

BY DAVID FIELDER, CHIEF SCIENTIFIC OFFICER

You probably haven't heard about avenanthramides, but you have heard about the therapeutic benefits of oatmeal. For centuries, our ancestors have known about the soothing relief that oatmeal provides for skin. In fact, Ceapro was the company that linked the science of these molecules unique to oats and the therapeutic benefits oats provide to the skin. Today, we have a commercial avenanthramide product that is primarily sold for dermatology benefits for the global cosmetic and personal care market. The anti-histamine, anti-inflammatory, and anti-oxidant properties of avenanthramides are ideal for a wide range of dermatology products. We typically have to screen hundreds of samples of oats to choose the feedstock that we'll use for manufacturing our product, and the amount found in oats is minute. Hence, our markets have historically been limited to the personal care and cosmetic sector where we sell everything we make. There is a lot of evidence that avenanthramides can provide a lot of benefits when consumed, including conditions such as atherosclerosis, inflammatory bowel disease, colon cancer, and exercise induced inflammation. But due to limited supplies today, it would be difficult to exploit these opportunities commercially.



In 2012, we identified a new opportunity that could give Ceapro the capability to develop new markets for avenanthramides, a win-win scenario for both Ceapro and Canadian agriculture. We successfully negotiated an exclusive license for all fields of use with Agriculture and Agri-Food Canada (AAFC) to a "false-malting" technology that was developed by Dr. Bill Collins, an AAFC senior research scientist who first isolated and characterized avenanthramides nearly 25 years ago. This technology will allow Ceapro to boost the level of avenanthramides in certain oat varieties to levels that are in excess of five times Ceapro's current feedstock selections. Once the technology is implemented, it will have a tremendous effect on our ability to expand the supply and profit margins of avenanthramides and provide the flexibility needed to expand existing markets.

But the bigger potential will lie in being able to grow as much high avenanthramide oats as desired with the ability to sell specialized highly therapeutic oats to the food industry that is increasingly searching to deliver functional health benefits. I look forward to the day when avenanthramides are being consumed and providing a multitude of health benefits to the world or when the pharmaceutical industry wants to look at avenanthramides as a cost-effective novel botanical drug solving health problems we are facing today.

This is a great Canadian story - Ceapro, AAFC, and tremendous novel crop potential for Canadian agricultural producers coming together on the world stage - and as a Ceapro employee and shareholder, I am really looking forward to implementing this technology and watching avenanthramides become a household word that is associated with Ceapro.



SWEET BLUE LUPIN PEPTIDE - A NATURAL COLOR LOCK TECHNOLOGY FOR THE HAIR CARE INDUSTRY

BY DR. PAUL MOQUIN, MANAGER - RESEARCH AND DEVELOPMENT PROJECTS

We discovered sweet blue lupin through the assistance of Agriculture and Rural Development Alberta who were investigating the lupin as a new crop opportunity for Alberta. At the same time, we were looking for a novel source of protein to manufacture a natural peptide for the hair care industry. In early 2011, we conducted some preliminary studies to assess the effect of this new product on hair penetration, tensile strength, and colour fastness. We were pleased when these studies showed several positive attributes. Indeed, these new sweet blue lupin peptides showed that they could completely penetrate hair fibres into the cortex and medulla in a single application, thereby improving hair elasticity and increasing hair strength. Based on the feedback and advice from our technical partner, it was suggested we consider testing our product for the ability to retard colour dye washout, a market which is large and still in need of natural solutions.



We were pleased when our studies showed strong color lock performance on par with some of the best synthetic ingredients. Our belief in this product was further reinforced when a major multi-national company launched a line of hair care products using sweet blue lupin for this very key functional performance.

We've recently noted that potential customers have requested samples of our Sweet Blue Lupin Peptides when they heard about it, and we have already seen some of these sample requests translate into new orders - a good sign from multiple companies that IT WORKS!

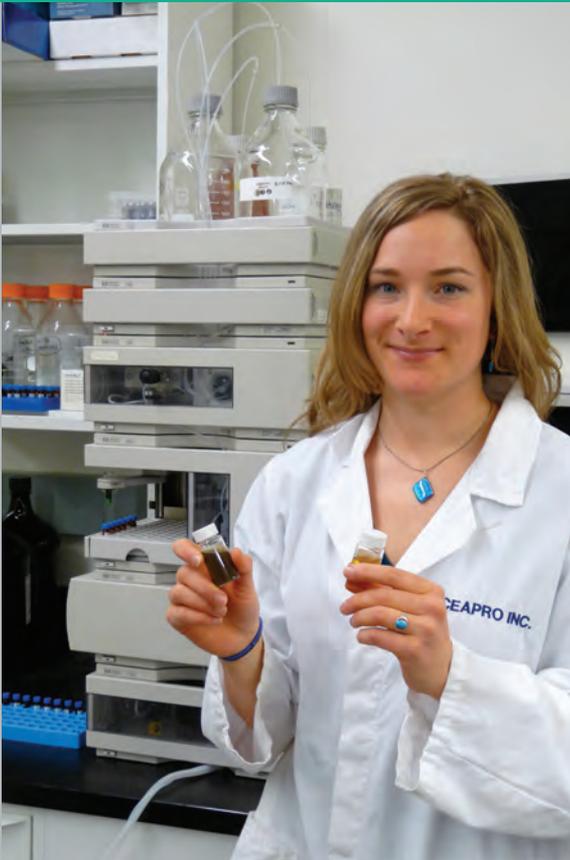
Given that this is a young product, we expect more formulators will start evaluating this product in 2012. We recently decided to carry out several other studies for other niche hair indications which can greatly enhance the value of this product and expand into new hair care applications.

I am currently working on a second generation sweet blue lupin product and fully expect development to be completed this year. This will be a preservative free flowing powder that will respond to our customers' feedback and requests.



SPEARMINT - MULTIFUNCTIONAL SUPERMINT

BY DR. CHRISTINA ENGELS, RESEARCH SCIENTIST



I am a natural product chemist who has completed PhD studies at the University of Alberta where my work involved plant-derived polyphenolic compounds with anti-microbial activity.

A few years ago, Ceapro licensed a promising spearmint variety from the University of Guelph. Unlike typical spearmint varieties, this plant contains very little essential oils but produces very high amounts of antioxidant and anti-inflammatory compounds, making it a potential source of novel and innovative health products for different markets. The plant has the ability to produce at least two and maybe three harvests in a given year providing an attractive novel crop opportunity for Canadian farmers. Currently, Ceapro is propagating the plant in multiple distinct regions of Canada to guard against the risk of crop failure in one region and assure supply continuity.

This past year, I've produced several prototype extracts from spearmint for the personal care industry. We're screening these extracts at our laboratory in Charlottetown, PEI for a wide range of potential biological activities, which will allow us to develop a final product formulation.

During 2011, Ceapro expanded its license with the University of Guelph to have access to the functional food and drink market. My work in the lab has shown that the spearmint makes a very nice tea with high levels of rosmarinic acid that could be used as a therapy for inflammatory conditions like osteoarthritis. Other potential fields of use could include the equine and companion animal markets.

This year, we will continue to multiple up the crop and evaluate commercial harvesting methods as well as completing the development of a unique ingredient for the Cosmetic and Personal Care markets.



SUPERCRITICAL FLUID SPRAY DRYING TECHNOLOGY - A NEW PLATFORM TECHNOLOGY

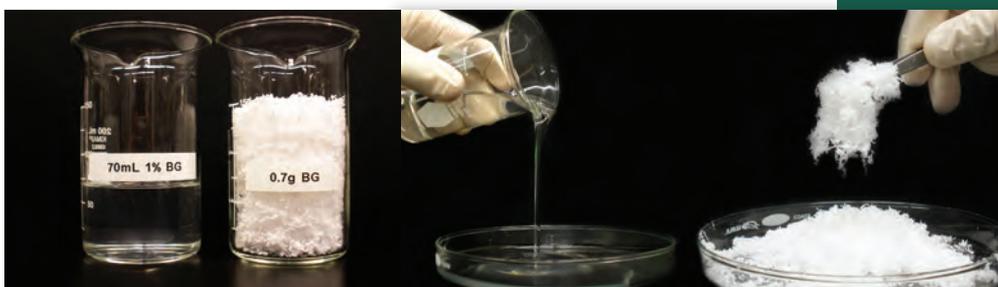
BY DR. BERNHARD SEIFRIED, RESEARCH SCIENTIST

While at the University of Alberta pursuing my PhD, I co-invented a technology using Supercritical fluid technology in a very novel way. While this technology is typically used for extractions, I've developed a way to use it as a novel drying technology. A lot of my work was done using cereal based beta glucan, and ironically when I graduated, there was Ceapro in the same city - a company selling oat beta glucan that has a large lab scale supercritical fluid extractor. It was a great match and I joined them in 2010 with the intent to scale up and commercialize this technology.

Because we have done most of our work to date with beta glucan, it is easy to think of this technology as "beta glucan powder" but the technology is really a lot more. To date, we have found the technology works well with water soluble polysaccharides, gums, and biopolymers at mild operating conditions, thereby proving to be a good platform technology for temperature sensitive actives. The process conditions facilitate the production of preservative free, sterile products, powders, fibres, and agglomerates. The wide range of very fine structures this technology produces facilitates easy solubilisation which is essential for many drying technologies to be successful. I believe this technology is capable of being used for impregnation, coating, and encapsulation of bioactives for cosmetic and pharmaceutical delivery systems.

So far, I have scaled up well beyond the Ceapro lab unit capacity to pilot plant scale at the BioFood Tech Centre in Charlottetown. Scaling up to pilot plant scale has required that I design and custom fabricate a lot of equipment and this does take some time. I am pleased to report the progress has been excellent to date with the beta glucan purity in excess of 90%. By tuning the processing conditions, the dried beta glucan can be generated in the form of microfibrils, spongy material or free flowing powder, which show all excellent solubilisation properties. We have had interest from both the food and specialty pharmaceutical sector based on the quality samples generated.

I look forward to continuing the commercial development of this platform technology in 2012.



EVALUATION OF THERAPEUTIC BENEFITS OF CEAPRO COMPOUNDS

BY DR. AZOY KUNDU, RESEARCH SCIENTIST



Ceapro's second R&D laboratory located in Charlottetown, PEI, in collaboration with the National Research Council's Institute of Nutrisciences and Health (NRC-INH), complements Ceapro's other laboratory in Edmonton, Alberta by investigating the therapeutic benefits of their bioactive ingredients at a molecular level through a series of biological assays in human skin cells. We are testing the bioactivity of Ceapro's existing ingredients to investigate new performance markers as well as those from new botanicals for possible future products. New scientific data supports marketing and sales efforts to allow Ceapro's products to remain competitive in a very challenging global market.

To conduct our in vitro studies, we are using different types of human skin cells such as primary epidermal keratinocyte cells, dermal fibroblast cells, and mast cells (the major histamine producing cell in human body).

Key to these biological assays is to initially determine the non-toxic doses of bioactive ingredients for each of the human skin cells used. This information is important to select the suitable doses for in vitro studies. Currently, we are testing the Ceapro ingredients for the following therapeutic benefits:

- Anti-allergic (inhibit histamine release from human body)
- Anti-inflammatory (reduces the inflammation, which is thought to be the culprit behind the visible signs of aging)
- Anti-aging (aging skin is a natural phenomenon, however changes in collagen deposition may serve as a primary signal in the etiology of aging)
- Reduction of oxidative stress (inhibition of the generation of nitric oxide and reactive oxygen species. Oxidative stress can damage tissues, DNA, and protein).
- Anti-elastase activity (anti-elastase capability prevents loss of skin elasticity and skin aging)
- Anti-collagenase (collagenase is harmful in cells, it cleaves other molecules such as fibronectin, aggrecan, elastin, etc.).
- Skin whitening (presence of tyrosinase enzyme inhibits skin whitening and compounds inhibiting tyrosinase are of great value)
- Beta-glucan properties on cell regeneration and wound healing
- Effects on psoriasis biomarkers, such as interleukine-8 (IL-8), human beta-defensin (hBD-2, -3), and cathelicidin (LL-37) (compounds inhibiting releases of IL-8, hBD-2, -3, LL-37 in skin cells might be beneficial to protect psoriasis).



We have already observed interesting anti-inflammatory, anti-oxidant, anti-elastase, and anti-collagenase activities in some Ceapro compounds, which have potential impacts on human skin health, such as skin aging. Compounds that inhibit inflammation, oxidative stress, elastase, and collagenase activities are of great value to the global cosmetic and personal care industry. The use of gene arrays this year will be an important tool allowing Ceapro researchers to potentially identify new therapeutic benefits not previously identified, giving Ceapro a competitive edge in this global market sector.

III MANAGEMENT'S DISCUSSION & ANALYSIS

The MD&A provides commentary on the results of operations for the years ended December 31, 2011 and 2010, the financial position as at December 31, 2011, and the outlook of Ceapro Inc. ("Ceapro") based on information available as at April 27, 2012. The following information should be read in conjunction with the audited consolidated financial statements as at December 31, 2011, and related notes thereto, which are prepared in accordance with International Financial Reporting Standards (IFRS), as well as the audited consolidated financial statements for the year ended December 31, 2010 prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP) and the Management's Discussion and Analysis (MD&A) for the year ended December 31, 2010. All comparative percentages are between the periods ended December 31, 2011 and 2010 and all dollar amounts are expressed in Canadian currency, unless otherwise noted. Additional information about Ceapro can be found on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS

This MD&A offers our assessment of Ceapro's future plans and operations as at April 27, 2012, and contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, including those discussed below. You are cautioned that the assumptions used in the preparation of forward-looking information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Actual results, performance, or achievements could differ materially from those expressed in, or implied by, these forward-looking statements. No assurance can be given that any of the events anticipated will transpire or occur, or if any of them do so, what benefits Ceapro will derive from them. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise unless required by law.

VISION, CORE BUSINESS, AND STRATEGY

Ceapro Inc. (Ceapro) is incorporated under the Canada Business Corporations Act; and its wholly-owned subsidiaries, Ceapro Technology Inc., Ceapro Veterinary Products Inc., Ceapro Active Ingredients Inc., and Ceapro BioEnergy Inc. are incorporated under the Alberta Business Corporations Act. Ceapro (P.E.I.) Inc. is a wholly owned subsidiary incorporated in Prince Edward Island. Ceapro USA Inc. is a wholly-owned subsidiary incorporated in the state of Nevada. Ceapro is a growth stage biotechnology company. Our primary business activities relate to the development and commercialization of natural products for personal care, cosmetic, medical, and animal health industries using proprietary technology and natural, renewable resources.

Our products include:

- A commercial line of natural active ingredients, including *beta glucan*, *avenanthramides (colloidal oat extract)*, *oat powder*, *oat oil*, *oat peptides*, and *lupin peptides* which are marketed to the personal care, cosmetic, medical, and animal health industries through our distribution partners and direct sales; and
- Veterinary therapeutic products, including an *oat shampoo*, an *ear cleanser*, and a *dermal complex/conditioner*, which are manufactured and marketed to veterinarians in Japan and Asia, through agreements with Daisen Sangyo Co. Ltd.

Other products and technologies are currently in the research and development or pre-commercial stage. These technologies include:

- *CeaProve*[®], a diabetes test meal to screen pre-diabetes and to determine dosage levels for diabetes oral therapy, and to monitor the condition of pre-diabetics;
- A *drug delivery* platform using our *beta glucan* technology to deliver compounds for uses ranging from wound care and therapy, to skin care treatments that reduce the signs of aging;

- An extension to *the active ingredients* product range offering, through new plant extract products including products from unique varieties of spearmint and rosehips; and
- A variety of novel manufacturing technologies including “Pressurized Green Solvent” drying technology which is currently being tested on oat beta glucan but may have application for multiple classes of compounds.

Our vision is to be a global leader in developing and commercializing products for the human and animal health markets through the use of proprietary technology and renewable resources. We act as innovator, advanced processor, and formulator in the development of new products. We deliver our technology to the market through distribution partnerships and direct sales efforts. Our strategic focus is in:

- Identifying unique plant sources and technologies capable of generating novel natural products;
- Increasing sales and expanding markets for our current active ingredients;
- Developing and marketing additional high-value proprietary therapeutic natural products;
- Developing and improving manufacturing technologies to ensure efficiencies; and
- Advancing new partnerships and strategic alliances to develop new commercial active ingredients and manufacturing technologies.

As a knowledge-based enterprise, we will also expand and strengthen our patent portfolio and build the necessary manufacturing infrastructure to become a global technology company.

Our business growth depends on our ability to access global markets through distribution partnerships and direct sales. Our marketing strategy emphasizes providing technical support to our distributors and their customers and generating direct sales to maximize the value of our technology and product utilization. Our vision and business strategy are supported by our commitment to the following core values:

- Adding value to all aspects of our business;
- Enhancing the health of humans and animals;
- Discovering, extracting, and commercializing new, therapeutic natural ingredients;
- Producing the highest quality work possible in products, science, and business; and
- Developing personnel through guidance, opportunities, and encouragement.

To support these objectives, we believe we have strong intellectual and human capital resources and we are developing a strong base of partnerships and strategic alliances to exploit our technology. The current economic environment provides challenges in obtaining financial resources to fully exploit opportunities. To fund our operations, Ceapro relies upon revenues primarily generated from the sale of active ingredients, and the proceeds of public and private offerings of equity securities, debentures, government grants and loans, and other investment offerings.

RISKS AND UNCERTAINTIES

Biotechnology companies are subject to a number of risks and uncertainties inherent in the development of any new technology. General business risks include: uncertainty in product development and related clinical trials and validation studies; the regulatory environment, for example, delays or denial of approvals to market our products; the impact of technological change and competing technologies; the ability to protect and enforce our patent portfolio and intellectual property assets; the availability of capital to finance continued and new product development; and the ability to secure strategic partners for late stage development, marketing, and distribution of our products. To the extent possible, we pursue and implement strategies to reduce or mitigate the risks associated with our business.

The Company has exposure to credit, liquidity, and market risk as follows:

A) CREDIT RISK

Accounts receivable

The Company makes sales to customers that are well-established and well-financed within their respective industries. Based on previous experience, the counterparties had zero default rates and management views this risk as minimal. Approximately 81% of accounts receivable are due from two customers at December 31, 2011 and all accounts receivable are current. These main customers present good credit quality and historically have a high quality credit rating.

Cash and cash equivalents

The Company has cash and cash equivalents in the amount of \$592,259 at December 31, 2011 and mitigates its exposure to credit risk on its cash balances by maintaining its bank accounts with Canadian Chartered Banks and investing in low risk, high liquidity investments.

The Company received \$750,000 under a capital expenditure grant agreement and has presented this amount as deferred revenue and considers it restricted cash as it can be spent only for qualified expenditures.

There are no past due or impaired financial assets. The maximum exposure to credit risk is the carrying amount of the Company's accounts receivable, cash and cash equivalents, and restricted cash and cash equivalents. The Company does not hold any collateral as security.

B) LIQUIDITY RISK

Liquidity risk relates to the risk that the Company will encounter difficulty in meeting its financial obligations. The long-term debt matures in January 2013. It is the intention of the Company that refinancing will be negotiated at that time should it be required. The Company may be exposed to liquidity risks if it is unable to collect its trade accounts receivable balances in a timely manner, which could in turn impact the Company's long-term ability to meet commitments under its current facilities. In order to manage this liquidity risk, the Company regularly reviews its aged accounts receivable listing to ensure prompt collections. The Company regularly reviews its cash availability and whenever conditions permit, the excess cash is deposited in short-term interest bearing instruments to generate revenue while maintaining liquidity. There is no assurance that the Company will obtain sufficient funding to execute its strategic business plan.

The following are the contractual maturities of the Company's financial liabilities and obligations.

	0 - 1 YEAR	1 - 3 YEARS	4 - 7 YEARS	TOTAL
Accounts payable and accrued liabilities	\$ 624,154	\$ -	\$ -	\$ 624,154
Long-term debt, including interest	208,613	1,006,951	-	1,215,564
Royalties interest payable	33,366	-	-	33,366
Royalty financial liability	74,057	189,566	-	263,623
Repayable research funding	52,133	32,500	-	84,633
Repayable CAAP funding	-	30,770	92,311	123,081
Total	\$ 992,323	\$ 1,259,787	\$ 92,311	\$ 2,344,421

C) MARKET RISK

Market risk is comprised of interest rate risk, foreign currency risk, and other price risk. The Company's exposure to market risk is as follows:

1. Foreign currency risk

Foreign currency risk arises from the fluctuations in foreign exchange rates and the degree of volatility of these rates relative to the Canadian dollar.

The following table summarizes the impact of a 1% change in the foreign exchange rates of the Canadian dollar against the US dollar (USD) on the financial assets and liabilities of the Company.

	CARRYING AMOUNT (USD)	FOREIGN EXCHANGE RISK (USD)	
		-1% EARNINGS & EQUITY	+1% EARNINGS & EQUITY
Financial assets			
Accounts receivable	\$ 424,807	\$ 4,248	\$ (4,248)
Financial Liabilities			
Accounts payable and accrued liabilities	\$ 177,783	\$ (1,778)	\$ 1,778
Total increase (decrease)		\$ 2,470	\$ (2,470)

The carrying amount of accounts receivable and accounts payable and accrued liabilities in USD represents the Company's exposure at December 31, 2011.

2. Interest rate risk

The Company has minimal interest risk because its long-term debt is a fixed rate of 5.49%. However, in the event of a default, the rate would increase to 7.49% and result in an increase in the required monthly principal and interest payment by \$1,541.

Management believes that changes in interest rates will not have a material impact on the Company as the Company's long-term debt is due in January, 2013.

3. Share price risk

- Ceapro's share price is subject to equity market price risk, which may result in significant speculation and volatility of trading due to the uncertainty inherent in the Company's business and the technology industry.
- There is a risk that future issuance of common shares may result in material dilution of share value, which may lead to further decline in share price. The expectations of securities analysts and major investors about our financial or scientific results, the timing of such results, and future prospects, could also have a significant effect on the future trading price of Ceapro's shares.

4. People and process risk

A variety of factors will affect Ceapro's future growth and operating results, including the strength and demand for the Company's products, the extent of competition in our markets, the ability to recruit and retain qualified personnel, and the ability to raise capital.

Ceapro's consolidated financial statements are prepared within a framework of IFRS selected by management and approved by the Board of Directors. The assets, liabilities, revenues, and expenses reported in the consolidated financial statements depend to varying degrees on estimates made by management. An estimate is considered a critical accounting estimate if it requires management to make assumptions about matters that are highly uncertain, and if different estimates that could have been used would have a material impact. The significant areas requiring the use of management estimates relate to provisions made for inventory valuation, amortization of property and equipment, the assumptions used in determining share-based compensation, the interest rates used in determining the employee future benefits obligation, the liability portion of convertible debentures, the liability on the license agreement, and the estimated sales projections to value the royalty financial liability. These estimates are based on historical experience and reflect certain assumptions about the future that we believe to be both reasonable and conservative. Actual results could differ from those estimates. Ceapro continually evaluates the estimates and assumptions.

i) Loss of key personnel

Ceapro relies on certain key employees whose skills and knowledge are critical to maintaining the Company's success. Ceapro has procedures in place to identify and retain key employees and always attempts to be competitive with compensation and working conditions.

ii) Interruption of raw material supply

Interruption of key raw materials could significantly impact operations and our financial position. Interruption of supply could arise from weather related crop failures or from market shortages. Ceapro attempts to purchase key raw materials well in advance of their anticipated use.

iii) Environmental issues

Violations of safety, health, and environmental regulations could limit operations and expose the Company to liability, cost, and reputational impact. In addition to maintaining compliance with national and provincial standards, Ceapro maintains internal safety and health programs.

iv) Regulatory compliance

As a natural extract producer, Ceapro is subject to various regulations and violation of these could limit markets into which we can sell. Ceapro has introduced a range of procedures which will ensure that Ceapro is well prepared for new regulations and obligations that may be required.

ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

The consolidated financial statements included in this annual MD&A reflect the adoption of IFRS that are in effect on December 31, 2011. Periods prior to January 1, 2010 have not been restated and were in accordance with Canadian GAAP which was applied during the periods prior to the effective date of the Company's adoption of IFRS. Our consolidated financial statements subsequent to this report will be prepared in accordance with IFRS.

Note 3 to the consolidated financial statements gives further information with regards to the conversion to IFRS, including a reconciliation of key components of our financial statements previously prepared under Canadian GAAP to those under IFRS as at and for the year ended December 31, 2010 and as at January 1, 2010.

FUTURE ACCOUNTING PRONOUNCEMENTS

FINANCIAL INSTRUMENTS DISCLOSURE

In October 2010, the IASB issued amendments to IFRS 7 – Financial Instruments: Disclosures that enhance the disclosure requirements in relation to transferred financial assets. The amendments are effective for annual periods beginning on or after July 1, 2011, with earlier application permitted. The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

FINANCIAL INSTRUMENTS

The IASB intends to replace IAS 39 – Financial Instruments: Recognition and Measurement ("IAS 39") in its entirety with IFRS 9 – Financial Instruments ("IFRS 9") in three main phases. IFRS 9 will be the new standard for the financial reporting of financial instruments that is principle-based and less complex than IAS 39. In November 2009 and October 2010, phase 1 of IFRS 9 was issued and amended, respectively, which addressed the classification and measurement of financial assets and financial liabilities. IFRS 9 requires that all financial assets be classified as subsequently measured at amortized cost or at fair value based on the Company's business model for managing financial assets and the contractual cash flow characteristics of the financial assets. Financial liabilities are classified as subsequently measured at amortized cost except for financial liabilities classified as at fair value through profit or loss, financial guarantees, and certain other exceptions. On August 4, 2011, the IASB published for comments an exposure draft proposing to defer the

mandatory effective date of IFRS 9 from annual periods beginning on or after January 1, 2013 (with earlier application permitted) to annual periods beginning on or after January 1, 2015 (with earlier application permitted).

CONSOLIDATION

In May 2011, the IASB issued IFRS 10 – Consolidated Financial Statements (“IFRS 10”), which supersedes SIC 12 and the requirements relating to consolidated financial statements in IAS 27 – Consolidated and Separate Financial Statements. IFRS 10 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted under certain circumstances.

IFRS 10 establishes control as the basis for an investor to consolidate its investees and defines control as an investor’s power over an investee with exposure, or rights, to variable returns from the investee and the ability to affect the investor’s returns through its power over the investee.

In addition, the IASB issued IFRS 12 – Disclosure of Interest in Other Entities (“IFRS 12”) which combines and enhances the disclosure requirements for the Company’s subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The requirements of IFRS 12 include reporting of the nature of risks associated with the Company’s interests in other entities and the effect of those interests on the Company’s consolidated financial statements.

Concurrently with the issuance of IFRS 10, IAS 27, and IAS 28 – Investments in Associates (“IAS 28”) were revised and reissued as IAS 27 – Separate Financial Statements and IAS 28 – Investments in Associates and Joint Ventures to align with the new consolidation guidance. The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

JOINT VENTURES

In May 2011, the IASB issued IFRS 11 – Joint Arrangements (“IFRS 11”), which supersedes IAS 31 – Interest in Joint Ventures and SIC-13 – Jointly Controlled Entities – Non-Monetary Contributions by Venturers. IFRS 11 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted under certain circumstances. Under IFRS 11, joint arrangements are classified as joint operations or joint ventures based on the rights and obligations of the parties to the joint arrangements. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (“joint operators”) have rights to the assets and obligations for the liabilities relating to the arrangement. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (“joint ventures”) have rights to the net assets of the arrangement. IFRS 11 requires that a joint operator recognizes its portion of assets, liabilities, revenues, and expenses of a joint arrangement, while a joint venturer recognizes its investment in a joint arrangement using the equity method. The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements.

INCOME TAXES

In December 2010, the IASB issued an amendment to IAS 12 – Income Taxes that provide a practical solution to determining the recovery of investment properties as it relates to the accounting for deferred income taxes. The amendment is effective for annual periods beginning on or after January 1, 2012 with earlier application permitted. The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements.

FAIR VALUE MEASUREMENT

In May 2011, as a result of a convergence project undertaken by the IASB and the US Financial Accounting Standards Board, to develop common requirements for measuring fair value and for disclosing information about fair value measurements, the IASB issued IFRS 13 – Fair Value Measurement (“IFRS 13”). IFRS 13 is effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. IFRS 13 defines fair value and sets out a single framework for measuring fair value which is applicable to all IFRSs that require or permit fair value measurements or disclosures about fair value measurements. IFRS 13 requires that when using a valuation technique to measure fair value, the use of relevant observable inputs should be maximized while unobservable inputs should be minimized. The Company does not anticipate the application of IFRS 13 to have a significant impact on its consolidated financial statements.

FINANCIAL STATEMENTS PRESENTATION

In June 2011, the IASB issued amendments to IAS 1 – Presentation of Financial Statements (“IAS 1”) that require an entity to group items presented in the Statement of Comprehensive Income on the basis of whether they may be reclassified to earnings subsequent to initial recognition. For those items presented before taxes, the amendments to IAS 1 also require that the taxes related to the two separate groups be presented separately. The amendments are effective for annual periods beginning on or after July 1, 2012 with earlier adoption permitted. The Company does not anticipate the application of the amendments to IAS 1 to have a material impact on its consolidated financial statements.

EMPLOYEE BENEFITS

In June 2011, the IASB issued amendments to IAS 19 – Employee Benefits (“IAS 19”) that introduced changes to the accounting for the defined benefit plans and other employee benefits. The amendments include elimination of the options to defer, or recognize in full in earnings, actuarial gains and losses, and instead mandates the immediate recognition of all actuarial gains and losses in other comprehensive income, and requires use of the same discount rate for both the defined benefit obligation, and the expected asset return when calculating interest cost. Other changes include modification of the accounting for termination benefits and classification of other employee benefits. The amendments to IAS 19 are effective for annual periods beginning on or after January 1, 2013. The Company does not anticipate the application of the amendments to IAS19 to have a material impact on its consolidated financial statements.

RESULTS OF OPERATIONS – YEARS ENDED DECEMBER 31, 2011, 2010, AND 2009

CONSOLIDATED INCOME STATEMENT

<i>\$000S EXCEPT PER SHARE DATA</i>	2011 IFRS	%	2010 IFRS	%	2009 GAAP	%
Total revenues	5,786	100%	5,577	100%	4,370	100%
Cost of goods sold	2,538	44%	3,061	55%	2,252	52%
Gross margin	3,248	56%	2,516	45%	2,118	48%
Research and product development	997	17%	774	14%	577	13%
General and administration	1,374	24%	1,279	23%	1,469	34%
Selling and marketing	111	2%	69	1%	184	4%
Finance costs	181	3%	203	4%	328	8%
Income (loss) from operations	585	10%	191	3%	(440)	– 10%
Other operating loss	(7)	0%	(30)	– 1%	(55)	– 1%
Write off of property and equipment	–	0%	(12)	0%	–	0%
SGGF legal fees	–	0%	315	6%	426	10%
Net income (loss)	578	10%	464	8%	(69)	– 2%
Basic net income (loss) per common share	0.009		0.009		(0.000)	
Diluted net income (loss) per common share	0.009		0.009		(0.000)	
Total assets	4,171		2,820		2,771	
Long-term financial liabilities	1,206		1,384		1,997	

The Company's revenue increased by 4% or \$209,000 to \$5,786,000 from \$5,577,000 while cost of goods sold decreased by 17% or \$523,000 to \$2,538,000 from \$3,061,000.

These positive changes resulted in a significant increase in gross margin by 29% or \$732,000 to \$3,248,000 from \$2,516,000.

Income from operations has increased by \$394,000 to \$585,000 from \$191,000.

Net income increased 10% in 2011 in comparison with 2010.

There were significantly higher research and development expenditures in 2011 due to a large increase in product development and research activities.

The fourth quarter of 2011 revenue has been decreased by \$144,000 or 8% to \$1,552,000 from \$1,696,000 in 2010. Cost of goods sold decreased by \$219,000 or 26% from \$853,000 to \$634,000 in the fourth quarter. Gross margin increased by \$75,000 or 9% in the fourth quarter of 2011 in comparison with the same period of 2010.

REVENUE

\$000S	Year Ended December 31			Quarter Ended December 31		
	2011	2010	CHANGE	2011	2010	CHANGE
Total revenues	5,786	5,577	4%	1,552	1,696	- 8%

PRODUCT SALES

The sales to the personal care industry in 2011 rose \$209,000 or 4% primarily as a result of higher sales volumes of avenanthramides and beta glucan, the Company's main products.

The sales in the fourth quarter of 2011 decreased by \$144,000 or 8% to \$1,552,000 from \$1,696,000 in comparison with the fourth quarter of 2010 primarily as a result of decreased sales in volumes of beta glucan and oat oil partially compensated by increased sales in avenanthramides.

EXPENSES

COST OF GOODS SOLD AND GROSS MARGIN

\$000S	Year Ended December 31			Quarter Ended December 31		
	2011	2010	CHANGE	2011	2010	CHANGE
Sales	5,786	5,577	4%	1,552	1,696	- 8%
Cost of goods sold	2,538	3,061	- 17%	634	853	- 26%
Gross margin	3,248	2,516	29%	918	843	9%
Gross margin %	56%	45%		59%	50%	

Cost of goods sold is comprised of the direct raw materials required for the specific formulation of products, as well as direct labour, quality assurance and control, packaging, transportation costs, plant costs, and amortization on plant and equipment assets. Aside from labour, rent, quality control related expenses, overhead, and property plant and equipment amortization, the majority of costs are variable in relation to the volume of product produced or shipped.

The cost of goods sold fell by \$523,000 or 17%, from \$3,061,000 in 2010 to \$2,538,000 in 2011. The gross margin in 2011 is higher by 29% due to higher sales of 4% and lower cost of goods sold of 17%. The gross margin has been positively impacted in 2011 through greater manufacturing output from operating efficiencies implemented and the use of higher quality feedstock. The gross margin percentage increased by 11% from 45% in 2010 to 56% in 2011.

The cost of goods sold decreased by \$219,000 or 26% from \$853,000 in the fourth quarter of 2010 to \$634,000 in the same period of 2011. The gross margin increased in the fourth quarter of 2011 in comparison with the fourth quarter of 2010 by 9% or \$75,000 from \$843,000 to \$918,000, and the gross margin percentage increased in the fourth quarter of 2011 in comparison with the fourth quarter of 2010 by 9% from 50% to 59%, mostly due to significant decreased cost of goods sold of 26% partially offset by decreased sales of 8%.

RESEARCH AND PRODUCT DEVELOPMENT

<i>\$000S</i>	Year Ended December 31			Quarter Ended December 31		
	2011	2010	CHANGE	2011	2010	CHANGE
Salaries and benefits	603	381		172	143	
Regulatory and patents	118	128		42	23	
Other	120	159		69	68	
	841	668	26%	283	234	21%
Product development – CeaProve®	156	106	47%	29	27	7%
Total research and product development expenditures	997	774	29%	312	261	20%

During 2011, research and development expenses before CeaProve® development have increased by 26% due to a large increase in product development and research activities. CeaProve® costs have increased by 47% from \$106,000 to \$156,000 as a result of increased patent and contract manufacturing costs.

The same trends were responsible for an overall 20% increase in expenditures for 2011 during the fourth quarter of 2011 over the same period of 2010 from \$261,000 to \$312,000 with CeaProve® expenditures increasing 7% from \$27,000 to \$29,000.

GENERAL AND ADMINISTRATION

<i>\$000S</i>	Year Ended December 31			Quarter Ended December 31		
	2011	2010	CHANGE	2011	2010	CHANGE
Salaries and benefits	390	361		110	104	
Consulting	211	188		62	47	
Board of Directors compensation	174	168		41	30	
Insurance	121	114		32	29	
Accounting and Audit fees	113	90		35	24	
Rent	90	87		28	23	
Public Company Costs	53	44		2	6	
Travel	83	65		29	19	
Depreciation	36	37		12	11	
Legal	16	54		10	1	
Other	87	71		20	24	
Total general and administration expenses	1,374	1,279	7%	381	318	20%

General and administration expenses for 2011 increased by \$95,000 or 7% from \$1,279 to \$1,374 as a result of increased expenses for salaries and benefits of \$29,000, consulting of \$23,000, directors' compensation of \$6,000, insurance of \$7,000, accounting and audit fees of \$23,000, rent of \$3,000, public company costs of \$9,000, travel of \$18,000, and other expenses of \$16,000 offset by decreased depreciation of \$1,000 and legal expenses of \$38,000. Legal expenses declined by \$38,000 due to lessened requirements for legal services and recoveries of previously accrued amounts.

General and administration expense for the fourth quarter of 2011 increased by \$63,000 or 20% from \$318,000 to \$381,000 as a result of increased expenses for salaries and benefits of \$6,000, consulting of \$15,000, board of directors

compensation of \$11,000, insurance of \$3,000, accounting and audit fees of \$11,000, rent of \$5,000, travel of \$10,000, legal of \$9,000, and depreciation of \$1,000. There was a decrease of public company costs of \$4,000 and other expenses of \$4,000.

SALES AND MARKETING

\$000S	Year Ended December 31			Quarter Ended December 31		
	2011	2010	CHANGE	2011	2010	CHANGE
Travel	45	30		10	15	
Consulting	36	29		9	2	
Advertising	12	–		3	–	
Courses & Conferences	9	5		1	1	
Other	9	5		3	2	
Total sales and marketing	111	69	59%	26	20	30%

Sales and marketing expenses in 2011 increased by \$42,000 or 59% and the fourth quarter of 2011 showed an increase in expenditures of \$6,000 or 30% versus 2010 due to targeted expansion activities.

The Company is currently reviewing new marketing initiatives for 2012 and anticipates continued participation at major personal care and cosmetic conferences, and travel to visit current and potential customers, as well as increased consulting fees to assist in identifying and implementing new marketing initiatives.

OTHER OPERATING LOSS (INCOME)

\$000S	Year Ended December 31			Quarter Ended December 31		
	2011	2010	CHANGE	2011	2010	CHANGE
Foreign exchange losses	32	28		(1)	24	
Other losses (gains)	(25)	2		(24)	2	
	7	30	–77%	(25)	26	–196%

Foreign exchange losses in 2011 were greater versus 2010 by \$4,000 as a result of a steady decline of the U.S. dollar versus Canadian dollar in the first six months of the year. There were other gains in 2011 of \$25,000 mostly comprised of revenue in the fourth quarter of 2011 from non-core activities in the amount of \$20,000 which were not present in 2010.

Other operating losses in the fourth quarter of 2011 are comprised of foreign exchange gains of \$1,000 and other gains of \$24,000 compared to foreign exchange loss of \$24,000 and other loss of \$2,000 in the same period of 2010. Losses were lower in the fourth quarter of 2011 versus 2010 as the U.S. dollar strengthened against the Canadian dollar.

FINANCE COSTS

<i>\$000S</i>	Year Ended December 31			Quarter Ended December 31		
	2011	2010	CHANGE	2011	2010	CHANGE
Interest on royalty financial liability	44	64		5	17	
Interest on long-term loan	60	70		13	17	
Interest on convertible debentures	40	41		10	10	
Accretion of convertible debentures	32	28		9	7	
Accretion of CAAP loan	4	-		2	-	
Bank charges	1	-		-	-	
	181	203	- 11%	39	51	- 24%

As at December 31, 2011, royalty investors received royalties equal to 2.285% (2010 – 2.285%) of revenues from product sales and royalty, license, and product development fees of active ingredients and veterinary therapeutic products and CeaProve®, to a maximum of two times the amount invested. AVAC Ltd. receives royalties of up to 2.5% to 5% of revenues from eligible product sales, to a maximum of one and a half to two times the amount invested. Royalty expenses will vary directly with fluctuations in eligible product sales, royalty, license and product development fees, product sales mix, and any new royalty interest offerings that may be completed.

Finance costs decreased in 2011 in comparison with 2010 due to decreasing interest expenses on royalty financial liabilities of \$20,000 and interest on a long-term loan of \$10,000 as a result of lower principal due to repayments.

On December 31, 2009, the Company issued secured convertible debentures for cash of \$500,000. The debentures incurred interest at 8% per annum, matured on December 31, 2011, and were convertible at any time at a price of \$0.10 per common share at the option of the holder. In 2011, the Company recorded interest expenses on convertible debentures in the amount of \$40,000 and accretion of \$32,000, a decrease of \$1,000 in interest compared to 2010 and an increase of \$4,000 for accretion as the liability moved closer to convertible debentures' maturity date.

In the fourth quarter of 2011, finance costs were \$39,000 in comparison with \$51,000 in the same period of 2010 due to decrease of interest on royalty financial liability of \$8,000 and interest on a long-term loan of \$4,000, accretion on convertible debentures increased by \$2,000 and accretion of a CAAP loan by \$2,000.

DEPRECIATION AND AMORTIZATION EXPENSES

In 2011, the total depreciation of \$297,000 (2010 – \$291,000) was allocated as follows: \$35,000 to general and administration expense (2010 – \$37,000), \$35,000 to inventory (2010 – \$4,000), and \$227,000 (2010 – \$250,000) to cost of goods sold. Depreciation expenses were increased mostly due to new property and equipment.

QUARTERLY INFORMATION

The following selected financial information is derived from Ceapro's unaudited quarterly financial statements for each of the last eight quarters, all of which cover periods of three months. All amounts shown are in Canadian currency.

\$000S EXCEPT PER SHARE DATA	2011 (IFRS)				2010 (IFRS)			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Total revenues	1,552	1,515	1,185	1,534	1,696	1,708	1,018	1,155
Net income (loss)	256	(108)	105	325	173	97	240	(46)
Basic net income (loss) per common share	0.005	(0.002)	0.002	0.006	0.003	0.002	0.005	(0.001)
Diluted net income (loss) per common share	0.005	(0.002)	0.002	0.006	0.003	0.002	0.005	(0.001)

Ceapro's quarterly sales and results primarily fluctuate due to variations in the timing of customer orders, different product mixes, and the capacity to manufacture products.

LIQUIDITY AND CAPITAL RESOURCES

CAPITAL EMPLOYED

\$000S	December 31, 2011	December 31, 2010
Non-current assets	2,307	1,713
Current assets	1,864	1,107
Current liabilities	(1,510)	(1,930)
Total assets less current liabilities	2,661	890
Non-current liabilities	2,143	1,545
Shareholders' equity (deficiency)	518	(655)
Total capital employed	2,661	890

Non-current assets increased by \$594,000 due to a depreciation provision of \$297,000 offset by the acquisition of \$126,000 of property and equipment, \$15,000 paid under the amended license agreement, and receiving restricted cash of \$750,000.

Current assets increased by \$757,000 and cash increased over 2010 by \$405,000. Inventories were higher by \$412,000; accounts receivables and prepaid expenses were lower by \$60,000.

Current liabilities totaling \$1,510,000 decreased by the net amount of \$420,000 due to decreased trade payables and accrued liabilities of \$238,000, a net royalty interest payable decrease of \$345,000 and convertible debentures principal repayment of \$467,000 offset by \$561,000 for sales orders prepayments and research grant advance of \$10,000, current portion of repayable research funding increase of \$40,000, current portion of long-term debt increase of \$8,000, and royalty financial liability increase of \$11,000.

Non-current liabilities totaling \$2,143,000 increased by the net amount of \$598,000 due to restricted cash received in the amount of \$750,000 under a capital expenditure grant agreement and recorded as deferred revenue, additional accrued employee future benefit obligation of \$27,000 and discounted CAAP loan recognized in the amount of \$57,000 offset by principal repayment of long-term debt in the amount of \$155,000, decreased royalty financial liability in the amount of \$76,000, and repayable research funding decrease of \$5,000.

Shareholders' equity of \$518,000 at December 31, 2011 improved by \$1,173,000 from a shareholders' deficiency of \$655,000 at December 31, 2010 due to increased share capital of \$545,000 including \$175,000 from the conversion of debt and \$370,000 from the conversion of the principal amount of matured convertible debentures, the recognition of share-based compensation in contributed surplus of \$50,000 and net income for 2011 of \$578,000.

NET DEBT

\$000S	December 31, 2011	December 31, 2010
Cash and restricted cash	592	187
Current financial liabilities*	938	1,930
Non-current financial liabilities*	1,206	1,385
Total financial liabilities	2,144	3,315
Net Debt	1,552	3,128

* Current and non-current financial liabilities include accounts payable and accrued liabilities, long-term debt, current portion of long term debt, convertible debentures, royalty interest payable, repayable research funding, current portion of repayable research funding, royalty financial liability, current portion of royalty financial liability, and CAAP loan.

The Company's net debt decreased by \$576,000 mostly due to increased cash and cash equivalents in the amount of \$405,000, repayment of matured convertible debentures in the amount of \$468,000, royalty interest repayment in the amount of \$345,000, long-term debt repayment in the amount of \$146,000, accounts payable and accrued liabilities decreased by \$238,000 and royalty financial liability decreased by \$66,000, net debt discounted the amount of the CAAP loan to \$57,000 and repayable research funding of \$35,000.

SOURCES AND USES OF CASH

The following table outlines our sources and uses of funds during 2011 and 2010.

\$000S	Year Ended December 31		Quarter Ended December 31	
	2011	2010	2011	2010
Sources of funds:				
Funds generated from operations (cash flow)	1,063	1,054	316	274
Changes in non-cash working capital items	157	(505)	49	(206)
Deferred revenue	750	-	750	-
Repayable CAAP Funding	123	-	-	-
Repayable research funding	50	50	-	-
	2,143	599	1,115	68
Uses of funds:				
Purchase of property and equipment	(126)	(91)	(38)	(54)
Purchase of license	(15)	-	(15)	-
Restricted cash received	(750)	-	(750)	-
Interest paid	(411)	(70)	(61)	(17)
Repayment of financial liability	(143)	(228)	(11)	-
Convertible debentures settlement	(130)	-	(130)	-
Repayable research funding repayment	(15)	-	(15)	-
Repayment of long-term debt	(146)	(139)	(37)	(36)
	(1,737)	(528)	(1,057)	(107)
Net change in cash flows	406	71	58	(39)

Cash flows provided by operating activities comprise the cash generated by operating activities less adjustments for items not affecting cash.

Net change in cash flow increased \$335,000 in 2011 in comparison with 2010. For the three months ended December 31, 2011, the net change in cash flow increased \$97,000 in comparison with the same period in 2010.

The Company estimates that the cash flows generated by its operating activities as well as cash available through other sources will be sufficient to finance its operating expenses, maintain capital investment, and service debt needs.

The Company relies upon revenues generated from the sale of active ingredients, the proceeds of public and private offerings of equity securities and debentures, and income offerings to support the Company's operations.

Total common shares issued and outstanding as at April 27, 2012 were 60,278,948 (April 18, 2011 – 56,578,948). In addition, 3,170,000 stock options as at April 27, 2012 (April 18, 2011 – 3,105,000) were outstanding that are potentially convertible into an equal number of common shares at various prices.

Ceapro's working capital position was \$354,000 at December 31, 2011, an improvement of \$1,177,000 from (\$823,000) at December 31, 2010.

To meet future requirements, Ceapro intends to raise additional cash through some or all of the following methods: public or private equity or debt financing, income offerings, capital leases, collaborative and licensing agreements, and joint venture or partnership financings. However, there is no assurance of obtaining additional financing through these arrangements on acceptable terms, if at all.

The ability to generate new cash will depend on external factors, many beyond the Company's control, as outlined in the Risks and Uncertainties section. Should sufficient capital not be raised, Ceapro may have to delay, reduce the scope of, eliminate, or divest one or more of its discovery, research, or development technologies or programs, any of which could impair the value of the business.

During the year ended December 31, 2010, the Company was approved for non-repayable funding in the amount of \$124,000 from Alberta Ingenuity. During 2011, the Company received \$62,000 (2010 – \$20,750) which was recorded as a reduction of research and product development expenses. The Company anticipates receiving an additional amount of \$41,250 in 2012 under this program.

The Company was approved for non-repayable funding for up to 50% of eligible costs to a maximum of \$99,900 under the Growing Forward Product Development program. The Company recognized \$60,076 during the year ended December 31, 2011 (2010 – \$39,824) as a reduction of research and product development expenses. This program has now been completed.

The Company was approved for non-repayable funding in the amount of \$50,000 for eligible costs from the Atlantic Canada Opportunities Agency. The Company recognized \$10,879 during the year ended December 31, 2011 (2010 – \$39,121) as a reduction of research and product development expenses. This program has now been completed.

The Company was approved for non-repayable funding to a maximum of \$21,250 of eligible expenditures under the Novel Crops Initiative program from the Prince Edward Island Department of Agriculture. The Company recorded the amount of \$5,000 as a reduction of research and product development expenditures under this program in the year ended December 31, 2011 (2010 – \$5,925). The Company anticipates receiving an additional amount of \$5,000 in 2012 under this program.

The Company was approved for non-repayable funding of \$7,055 under the Growing Forward Lean Manufacturing Initiative. The Company recognized \$5,823 as a reduction of the cost of certain property and equipment, and \$1,232 as a reduction of research and development expenditures in the year ended December 31, 2010. The full amount of \$7,055 was included in accounts receivable at December 31, 2010 and received in the first quarter of 2011. This program has now been completed.

The Company received a repayable non-interest bearing contribution for research and development expenditures in the amount of \$50,000 in 2011 (2010 – \$50,000) from Innovation PEI which is recorded as a repayable research funding

liability on the consolidated balance sheets less \$15,367 which was repaid. The contribution is repayable quarterly at a rate of one percent of sales revenue subject to a minimum payment of \$12,500 per quarter. The Company anticipates repayment of \$52,133 during the year ended December 31, 2012.

The Company was approved for non repayable grant funding from Innovation PEI for a maximum of \$100,000. During the year ended December 31, 2011, the Company received \$30,000, and recognized \$19,500 against eligible expenses and \$10,500 as deferred revenue. The Company anticipates an additional \$70,000 could be received in 2012.

The Company is eligible to claim up to \$1,339,625 of eligible research and development expenditures incurred in 2011 and 2012 under the Canadian Agricultural Adaptation Program. All amounts claimed under the program are repayable interest free over eight years beginning in 2013. The Company has received funding of \$123,081 to date under this program.

During the year ended December 31, 2011, the Company commenced a research and development project agreement. Under this project, the Company paid cash of \$56,177 in 2011, and will make an additional payment of \$28,236 in 2012. The other party to the research and development project agreement will make an in-kind contribution to the project of \$42,262.

During the year ended December 31, 2011, the Company entered into a Contribution Agreement with Alberta Innovates Bio Solutions (AI Bio Solutions) for a non-repayable grant contribution totaling up to \$1,600,000 towards the construction of a new bio-processing facility and subject to compliance with all terms and conditions of the agreement. In accordance with the agreement, the Company received \$750,000 in 2011 presently classified as restricted cash and cash equivalents, and anticipates additional amounts will be received as follows: \$650,000 in 2012, \$40,000 in 2013, and \$160,000 in 2014. It is anticipated that as these amounts are expended they will be recorded as a reduction of capital cost.

The Company is currently reviewing additional options available to raise capital.

RELATED PARTY TRANSACTIONS

During 2011, \$22,000 (2010 – \$22,000) of royalties were earned by employees and directors from their investment in previous Ceapro royalty offerings. As at December 31, 2011, \$6,000 (2010 – \$28,000) of royalties were payable to employees and directors. As at December 31, 2011, \$nil (2010 – \$72,000) of royalties payable to employees and directors were converted to common shares.

At December 31, 2011, officers and directors owned \$nil (2010 – \$70,000) of convertible debentures. During 2011, officers and directors earned \$6,000 of interest on convertible debentures (2010 – \$6,000). During 2011, officers and directors converted \$nil (2010 – \$3,000) of interest on convertible debentures into common shares.

During 2011, the Company paid key management salaries, short-term benefits, consulting fees, and director fees totaling \$485,000 (2010 – \$437,000), and key management personnel received share-based payments of \$49,000 (2010 – \$36,000).

During 2011, directors converted \$175,000 (2010 – \$nil) of fees payable to 1,590,909 common shares of the Company. Directors and officers converted \$70,000 (2010 – \$nil) of the principal amount of matured convertible debentures to 700,000 common shares of the Company. Amounts payable to directors was \$175,000 (2010 – \$140,000).

These transactions are in the normal course of operations and are measured at the amount of consideration established and agreed to by the related parties.

COMMITMENTS AND CONTINGENCIES

- a) During the year ended December 31, 2011, the Company and its wholly-owned subsidiary, Ceapro Veterinary Products Inc. were served with a statement of claim from AVAC Ltd. alleging damages of \$724,500 pursuant to a product development agreement. The Company and Ceapro Veterinary Products Inc. have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However, at this time, the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

Subsequent to December 31, 2011, the Company and its wholly-owned subsidiary, Ceapro Technology Inc. were served with a statement of claim from AVAC Ltd. alleging damages of \$1,470,500 pursuant to two product development agreements. The Company and Ceapro Technology Inc. have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However, at this time, the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

- b) During the year ended December 31, 2008, the Company recorded provisions of \$741,283 for disputed legal fees related to a previous litigation case that was settled with all defendants in 2009. The terms of the legal settlement were fully satisfied in 2009. During the second quarter of 2009, the Company was advised by one legal firm that they did not intend to pursue collection of their previously billed legal fees. The amount of the fees was \$426,300 and this was recorded as a recovery in the second quarter of 2009.

During the second quarter of 2010, management reviewed the exposure of the remaining provisions totaling \$314,983. Based upon the review by management at June 30, 2010 with its legal counsel and the circumstances applicable at that time, management believes the Company is no longer exposed to the remaining accrued legal fees liability, and the amount of \$314,983 was recorded as a recovery in the year ended December 31, 2010.

- c) During the year ended December 31, 2008, the Company entered into a licensing agreement with the University of Guelph for an exclusive variety of a mint plant. During the year ended December 31, 2011, the Company has entered into a new licensing agreement with the University of Guelph for additional market rights for the exclusive variety of a mint plant.

In accordance with the new agreement, there are future minimum royalty payments of \$10,000 per annum starting in 2012 for royalty payments which will be calculated as 5% of net sales from products derived from the mint plants.

- d) In the normal course of operations, the Company may be subject to litigation and claims from customers, suppliers, and former employees. Management believes that adequate provisions have been recorded in the accounts where required. Although it is not possible to estimate the extent of potential costs, if any, management believes that the ultimate resolution of such contingencies would not have a material adverse effect on the financial position of the Company.

SUBSEQUENT EVENTS

Subsequent to December 31, 2011, the Company and its wholly-owned subsidiary, Ceapro Technology Inc. were served with a statement of claim from AVAC Ltd. alleging damages of \$1,470,500 pursuant to two product development agreements. The Company and Ceapro Technology Inc. have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However, at this time, the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

OUTLOOK

"From Field to Formulator" – you will be hearing these words a lot from Ceapro in the future. It's what we do best, and to the personal care industry it represents key sought-after attributes like traceability and sustainability. It comprises activities in four key activities that are what Ceapro represents – plant source/agronomy, product development and scale-up, commercial manufacturing, and providing product solutions to our customers – the scientists and formulators who want the latest natural innovations Ceapro has to offer.

Starting with plant sources and agronomy, we head into 2012 excited on several fronts. With our spearmint project, we have demonstrated that we can grow the plants in multiple regions of Canada and most importantly, the high level of active ingredients has been confirmed and supports the competitive advantages we had expected this plant to provide. The plants will be further multiplied with new commercial growers in 2012. We have begun the process of developing extracts for testing, and anticipate that multiple products may be produced from this single plant. Ceapro is currently reviewing several other attractive plant and feedstock technologies with a view to in-licensing and expects to finalize agreements in the short term.

On the product development front, we anticipate that 2012 will be equally exciting. We are currently evaluating the spearmint extracts for multiple personal care applications including anti-inflammatory and natural preservative properties. Current work being performed at the University of Guelph suggests the high level of anti-inflammatories may have applications in the equine and companion animal markets as well as the human osteo-arthritis market. There is currently a human clinical trial ongoing examining the effects of a tea made from the spearmint on arthritis. A therapeutic tea product would represent huge growth potential for Ceapro. Ceapro has successfully made high quality soluble product versions of certain liquid formulations and it is anticipated there will be new powders launched in 2012. New generation avenanthramide products, also called colloidal oat extracts, are also being developed and promise to not only lead to new products, but also new markets including functional foods.

The area of manufacturing will perhaps be the most exciting news for Ceapro in 2012 as we move to building a new facility that is being kick started with a generous grant of \$1.6 million from AI Bio Solutions. Our new plant will incorporate several technology improvements currently being tested and optimized, and operate in a semi-continuous process rather than the current batch mode. The new plant will be designed to be Good Manufacturing Process compliant to meet the most rigorous quality standard our clients present. We anticipate this plant will have a capacity several times our current plant and allow for the production of several new products. We are aiming for full production by late 2013.

In 2012, Ceapro will continue to build on the capability to market its products better and with enhanced representation around the globe. New distributors will continue to be added to reach the worldwide audience, and Ceapro intends to complete a thorough marketing analysis in Q2 2012 with the assistance of a third party firm to identify, build, and support the infrastructure needed to market Ceapro products globally. This will be a comprehensive process and we anticipate we will make some additional marketing investments in 2012.

To our shareholders who have been with us for the long term, we have made tremendous progress over the last few years as evidenced by our balance sheet improvement. We have done the right things to build our business in a prudent and responsible way, and we are a company of substance that truly has accomplished more than most any other biotech company in Canada. We intend to continue to do the right things to build shareholder value and expect that eventually the capital markets will realize the true value of Ceapro.

ADDITIONAL INFORMATION

Additional information relating to Ceapro Inc., including a copy of the Company's Annual Report and Proxy Circular, can be found on SEDAR at www.sedar.com.

III CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S REPORT

TO THE SHAREHOLDERS OF **CEAPRO INC.**,

The accompanying consolidated financial statements of Ceapro Inc., and all information presented in this report, are the responsibility of Management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by Management in accordance with International Financial Reporting Standards. The consolidated financial statements include some amounts that are based on the best estimates and judgments of Management. Financial information used elsewhere in the report is consistent with that in the consolidated financial statements.

To further the integrity and objectivity of data in the consolidated financial statements, Management of the Company has developed and maintains a system of internal controls, which Management believes will provide reasonable assurance that financial records are reliable and form a proper basis for preparation of consolidated financial statements, and that assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for the consolidated financial statements in the report principally through its Audit Committee. The Audit Committee is appointed by the Board, and all of its members are outside and unrelated Directors. The Committee meets periodically with Management and the external auditors to discuss internal controls over the financial reporting process and financial reporting issues, to make certain that each party is properly discharging its responsibilities, and to review quarterly reports, the annual report, the annual consolidated financial statements, management's discussion and analysis, and the external auditors' report. The Committee reports its findings to the Board for consideration when approving the consolidated financial statements for issuance to the shareholders. The Company's auditors have full access to the Audit Committee, with and without Management being present.

The consolidated financial statements have been audited by the Company's auditors, Grant Thornton LLP, the external auditors, in accordance with auditing standards generally accepted in Canada on behalf of the shareholders.

SINCERELY,

SIGNED "Gilles Gagnon"
Acting President and Chief Executive Officer

SIGNED "Branko Jankovic, CA"
Chief Financial Officer



Independent Auditors' Report

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To the Shareholders of
Ceapro Inc.

We have audited the accompanying consolidated financial statements of Ceapro Inc., which comprise the consolidated balance sheets as at December 31, 2011, December 31, 2010 and January 1, 2010, and the consolidated statements of net income and comprehensive income, changes in equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Ceapro Inc. as at December 31, 2011, December 31, 2010, and January 1, 2010, and its financial performance and its cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

Edmonton, Canada

April 27, 2012

A stylized, handwritten-style signature of "Grant Thornton LLP" in black ink.

Chartered Accountants

CONSOLIDATED BALANCE SHEETS

	December 31 2011 \$	December 31 2010 \$ (note 3)	January 1 2010 \$ (note 3)
ASSETS			
Current Assets			
Cash and cash equivalents	592,259	186,690	115,502
Accounts receivable	465,446	570,362	151,144
Inventories (note 4)	691,411	279,425	516,821
Prepaid expenses and deposits	115,015	70,230	62,309
	1,864,131	1,106,707	845,776
Non-Current Assets			
Restricted cash and cash equivalents (note 10)	750,000	-	-
License (note 6)	36,000	24,000	27,000
Property and equipment (note 5)	1,520,659	1,689,052	1,897,878
	2,306,659	1,713,052	1,924,878
TOTAL ASSETS	4,170,790	2,819,759	2,770,654
LIABILITIES AND SHAREHOLDERS' DEFICIENCY			
Current Liabilities			
Accounts payable and accrued liabilities	624,154	862,163	846,538
Current portion of deferred revenue (note 10)	571,524	-	-
Current portion of long-term debt (note 7)	154,465	146,426	138,806
Royalties interest payable (note 9)	33,366	378,051	758,436
Current portion of royalty financial liability (note 9e)	74,057	63,360	49,857
Current portion of repayable research funding (note 24)	52,133	12,500	-
SGGF legal fees (note 20b)	-	-	314,983
Convertible debentures (note 8)	-	467,500	-
	1,509,699	1,930,000	2,108,620
Non-Current Liabilities			
Royalty financial liability (note 9e)	189,566	266,075	329,434
Employee future benefits obligation (note 11)	187,302	160,187	136,786
Deferred revenue (note 10)	750,000	-	-
Long-term debt (note 7)	926,535	1,081,000	1,227,426
CAAP loan (note 13)	57,432	-	-
Convertible debentures (note 8)	-	-	440,000
Repayable research funding (note 24)	32,500	37,500	-
	2,143,335	1,544,762	2,133,646
Shareholders' Equity (Deficiency)			
Share capital (note 12b)	6,315,858	5,770,858	5,479,202
Equity component of convertible debentures (note 8)	-	45,000	45,000
Contributed surplus (note 12c)	397,631	347,445	286,214
Deficit	(6,195,733)	(6,818,306)	(7,282,028)
	517,756	(655,003)	(1,471,612)
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)	4,170,790	2,819,759	2,770,654

CONTINGENCIES AND COMMITMENTS (note 20)

SUBSEQUENT EVENTS (note 26)

See accompanying notes

Approved on Behalf of the Board

SIGNED: "John Zupancic"

Director

SIGNED: "Edward Taylor"

Director

CONSOLIDATED STATEMENTS OF NET INCOME AND COMPREHENSIVE INCOME

Years ended December 31	2011 \$	2010 \$ (note 3)
Revenue (note 14)	5,786,174	5,576,636
Cost of goods sold	2,538,347	3,060,204
Gross margin	3,247,827	2,516,432
Research and product development	996,719	774,059
General and administration	1,374,030	1,279,012
Sales and marketing	111,359	69,513
Finance costs (note 17)	180,808	202,867
Income from operations	584,911	190,981
Other operating loss (note 16)	(7,338)	(29,964)
Write-off of property and equipment	-	(12,278)
SGGF legal fees recovery (note 20b)	-	314,983
Net income and comprehensive income for the year	577,573	463,722
Net income per common share (note 25):		
Basic	0.01	0.01
Diluted	0.01	0.01
Weighted average number of common shares outstanding	56,561,513	53,219,621

See accompanying notes

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Share Capital (note 12b) \$	Equity component of convertible debentures \$	Contributed surplus \$	Deficit \$	Shareholders' equity (deficiency) \$
Balance January 1, 2010 (note 3)	5,479,202	45,000	286,214	(7,282,028)	(1,471,612)
Shares issued for debt	291,656	-	-	-	291,656
Share-based payments	-	-	61,231	-	61,231
Net income for the year	-	-	-	463,722	463,722
Balance December 31, 2010 (note 3)	5,770,858	45,000	347,445	(6,818,306)	(655,003)
Shares issued for debt	545,000	-	-	-	545,000
Share-based payments	-	-	50,186	-	50,186
Transfer to deficit	-	(45,000)	-	45,000	-
Net income for the year	-	-	-	577,573	577,573
Balance December 31, 2011	6,315,858	-	397,631	(6,195,733)	517,756

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31	2011 \$	2010 \$ (note 3)
OPERATING ACTIVITIES		
Net income for the year	577,573	463,722
Adjustments to reconcile net income to cash provided by operating activities		
Finance costs	148,308	175,367
Depreciation and amortization	297,282	290,640
Write-off of property and equipment	-	12,278
Accretion on convertible debentures	32,500	27,500
Grant revenue recognized (note 13)	(69,990)	-
Employee future benefits obligation	27,115	23,401
Share-based payments	50,186	61,231
	1,062,974	1,054,139
CHANGES IN NON-CASH WORKING CAPITAL ITEMS		
Accounts receivable	104,915	(419,218)
Inventories	(411,986)	237,396
Prepaid expenses and deposits	(44,785)	(7,921)
Deferred revenue	571,524	-
Accounts payable and accrued liabilities	(63,009)	(315,012)
	156,659	(504,755)
	1,219,633	549,384
Interest paid	(411,393)	(69,808)
CASH GENERATED FROM OPERATIONS	808,240	479,576
INVESTING ACTIVITY		
Purchase of property and equipment	(125,889)	(91,092)
Purchase of license	(15,000)	-
	(140,889)	(91,092)
FINANCING ACTIVITIES		
Repayment of long-term debt	(146,426)	(138,806)
Repayable CAAP funding	123,081	-
Deferred revenue	750,000	-
Restricted cash and cash equivalents	(750,000)	-
Convertible debentures	(130,000)	-
Repayable research funding	50,000	50,000
Repayable research funding repayment	(15,367)	-
Repayment of royalty financial liability	(143,070)	(228,490)
	(261,782)	(317,296)
Increase in cash	405,569	71,188
Cash and cash equivalents at beginning of year	186,690	115,502
Cash and cash equivalents at end of year	592,259	186,690

See accompanying notes

The non-cash transaction described in note 12 (b) has been excluded from the statement of cash flows.

Cash and cash equivalents are comprised of \$334,681 (2010 – \$186,690) on deposit with financial institutions and \$257,578 (2010 – \$nil) held in money market mutual funds.

III NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF BUSINESS OPERATIONS

Ceapro Inc. (the "Company") is incorporated under the Canada Business Corporations Act and is listed on the TSX Venture Exchange. The Company's primary business activities relate to the marketing and development of various health and wellness products and technology relating to plant extracts.

The Company's head office address is Suite 4174 Enterprise Square, 10230 Jasper Avenue, Edmonton, AB T5J 4P6.

2. SIGNIFICANT ACCOUNTING POLICIES

A) STATEMENT OF COMPLIANCE

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and requires publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, these are the Company's first annual consolidated financial statements prepared in accordance with IFRS as issued by the International Accounting Standards Board. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of consolidated financial statements, including IFRS 1, First-time Adoption of International Financial Reporting Standards. The Company has consistently applied the same accounting policies in its opening IFRS balance sheet and throughout all periods presented, as if these policies had always been in effect. Note 3 discloses the impact of the transition to IFRS on the Company's reported equity as at January 1, 2010 and December 31, 2010 and comprehensive income for the year ended December 31, 2010, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010 previously reported under Canadian GAAP.

The accounting policies applied in these consolidated financial statements are based on IFRS as issued and outstanding as of December 31, 2011. The Board of Directors authorized these consolidated financial statements for issue on April 27, 2012.

B) BASIS FOR PRESENTATION

These consolidated financial statements have been prepared on the historical cost basis. All transactions are recorded on an accrual basis.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Ceapro Technology Inc., Ceapro Veterinary Products Inc., Ceapro Active Ingredients Inc., Ceapro BioEnergy Inc., Ceapro (P.E.I) Inc., and Ceapro USA Inc.

All intercompany accounts and transactions have been eliminated on consolidation.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C) USE OF MANAGEMENT JUDGMENTS, ESTIMATES, AND ASSUMPTIONS

The preparation of consolidated financial statements requires management to make critical judgments, estimates, and assumptions that affect the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses recorded during the reporting period. In making estimates and judgments, management relies on external information and observable conditions where possible, supplemented by internal analysis as required. Actual results may differ from those estimates. Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Policies that are critical for the presentation of the financial position and financial performance of the Company and that require estimates and judgments are discussed below.

EMPLOYEE BENEFITS

The Company has an unfunded post-employment defined benefit pension plan. The liability for this plan is presented in the balance sheet of the Company. The costs related to this pension plan are included in the income statement. The critical assumption used to determine the Company's obligation is the discount rate applied to the obligation. Management determines the appropriate discount rate at the end of each year by considering the interest rate of high quality corporate bonds that have terms to maturity approximating the terms of the obligation.

PROVISIONS

The Company records provisions for matters where a legal or constructive obligation exists at the balance sheet date, as a result of past events and a reliable estimate can be made of the obligation. These matters might include restructuring projects, legal matters, disputed issues, indirect taxes, and other items. These obligations may not be settled for a number of years and a reliable estimate has to be made of the likely outcome of each of these matters. These provisions represent our best estimate of the costs that will be incurred, but actual experience may differ from the estimates made and therefore affect future financial results. The effects would be recognized in the income statement.

TAXATION

The Company makes estimates in respect of tax liabilities and tax assets. Full provision is made for future and current taxation at the rates of tax prevailing at the year end unless future rates have been substantively enacted. These calculations represent our best estimate of the costs that will be incurred and recovered, but actual experience may differ from the estimates made and therefore affect future financial results. The effects would be recognized in the income statement, primarily through taxation.

The Company recognizes the deferred tax benefit related to deferred tax assets to the amount that is probable to be realized. Assessing the recoverability of deferred tax assets requires management to make significant estimates of future taxable profit. In addition, future changes in tax laws could limit the ability of the Company to obtain tax deductions from deferred tax assets.

INVENTORIES

Inventories are valued at the lower of cost and net realizable value. Cost of inventory includes cost of purchase (purchase price, import duties, transport, handling, and other costs directly attributable to the acquisition of inventories), cost of conversion, and other costs incurred in bringing the inventories to their present location and condition. Net realizable value for inventories is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Provisions are made in the income statement of the current period on any difference between book value and net realizable value.

PROPERTY AND EQUIPMENT

The Company provides for depreciation expenses on property and equipment at rates designed to amortize the cost of individual items and their material components over their estimated useful lives. Management makes estimates of future useful life based on patterns of benefit consumption and impairments based on past experience and market conditions. Impairment losses and depreciation expenses are presented in income statements of the current period.

FINANCIAL INSTRUMENTS

The Company has a royalty financial liability. The obligation is based on the present value of management's best estimate for eventual repayment which is based on estimated future sales. Changes in the sales estimates could significantly affect the value of the obligation at each reporting date.

SHARE-BASED PAYMENTS

The fair value of share-based payments is determined using the Black Scholes option pricing model based on estimated fair values at the date of grant. The Black Scholes option pricing model utilizes subjective assumptions such as expected price volatility and expected life of the award. Changes in these assumptions can significantly affect the fair value estimate. For more information see note 12.

CONVERTIBLE DEBENTURES

In 2009, the Company issued secured convertible debentures with coupon interest at 8% per annum, a maturity date of December 31, 2011, and are convertible at any time. Management calculated a liability portion of convertible debenture equal to the present value of future cash flows, including interest and principal repayments using an estimated discount rate that was determined based on instruments of comparable credit status. For more information see note 8.

D) CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, demand deposits, and all highly liquid short-term investments with original maturities of three months or less.

E) REVENUE RECOGNITION

Revenue from the sale of health and wellness products is recognized as revenue at the time the products are shipped to customers, title passes, significant risks and rewards have been transferred, and collectability is reasonably assured. Revenue is measured at the fair value of consideration received or receivable, less a provision for uncollectible amounts, excluding discounts, rebates, and sales taxes.

F) INVENTORIES

Inventories are valued at the lower of cost and net realizable value.

Costs of inventory include costs of purchase, costs of conversion, and any other costs incurred in bringing the inventories to their present location and condition. Costs of conversion include direct costs (materials and labor) and indirect costs (fixed and variable production overheads). Fixed overheads are allocated based on normal capacity. Raw materials are assigned costs by using a first-in-first-out cost formula and work-in-progress and finished goods are assigned costs by using a weighted average cost formula.

Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

G) PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost less accumulated depreciation and any accumulated impairment losses. Depreciation methods and rates are calculated as follows:

Manufacturing equipment	10 years straight-line
Office equipment	20% declining balance
Computer equipment	30% declining balance
Leasehold Improvements	Over the term of the lease

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cost for property and equipment includes the purchase price, import duties, non-refundable taxes, and any other costs directly attributable to bringing the asset into the location and condition to be capable of operating. Significant parts of an item of property and equipment with different useful lives are recognized and depreciated separately. Depreciation commences when the asset is available for use. The asset's residual values, useful lives, and method of depreciation are reviewed at each financial year end and adjustments are accounted for prospectively, if appropriate. An item of property and equipment is derecognized on disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of an asset is included in the income statement in the period the asset is derecognized.

H) BORROWING COSTS

Borrowing costs are capitalized when such costs are directly attributable to the acquisition, construction, or production of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to prepare for its intended use. All other borrowing costs are recognized as an expense in the period in which they are incurred.

I) IMPAIRMENT OF NON-FINANCIAL ASSETS

The carrying amounts of property and equipment and intangible assets with a finite life are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. For the purpose of measuring recoverable cash flows, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units or CGUs). If such indication exists, the Company estimates the recoverable amount of the assets, which is the higher of its fair value less cost to sell and its value in use. Value in use is estimated as the present value of future cash flows generated by this asset or CGU including eventual disposal. If the recoverable amount of an asset is less than its carrying amount, the carrying amount is reduced to its recoverable amount, and an impairment loss is recognized immediately in the profit or loss statement. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the lesser of the revised estimated recoverable amount and the carrying amount that would have been recorded, had no impairment loss been recognized previously. Any such recovery is recognized immediately in the income statement.

J) LEASES

Leases are classified as finance or operating leases. A lease is classified as a finance lease if it effectively transfers substantially the entire risks and rewards incidental to ownership.

At the commencement of the lease, the Company recognizes finance leases as an asset acquisition and an assumption of an obligation in the consolidated balance sheet at amounts equal to the lower of the fair value of the leased property or the present value of the minimum lease payments. The discount rate to be used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, the incremental borrowing rate is used. The interest element of the lease payment is recognized as finance cost over the lease term to achieve a constant periodic rate of interest on the remaining balance of the liability. Any initial direct costs of the lessee are added to the amount recognized as an asset. The useful life and depreciation method is determined on a consistent basis with the Company's policies for property and equipment. The asset is depreciated over the shorter of the lease term and its useful life.

All other leases are accounted for as operating leases, wherein payments are expensed on a straight-line basis over the term of the lease.

K) INTANGIBLE ASSETS

LICENSES

Licenses are recorded at cost and are amortized straight-line over the life of the license.

RESEARCH AND PRODUCT DEVELOPMENT EXPENDITURES

Research costs are expensed when incurred. Product development costs are also expensed when incurred unless they meet recognition criteria for capitalization. Costs are reduced by government grants and investment tax credits where applicable.

Following initial capitalization of product development expenditures, the asset is carried at cost less accumulated amortization and any accumulated impairment losses. Amortization commences when product development is completed and the asset is available for use. It is amortized over the period of expected future economic benefit. The expected lives of assets are reviewed on an annual basis, and if necessary, changes in useful lives are accounted for prospectively.

L) TRADE RECEIVABLES

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments (more than 30 days overdue) are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in the income statement within operating costs. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against other operating costs in profit or loss.

M) FOREIGN CURRENCY TRANSACTIONS

The Canadian dollar is the functional and presentation currency of the Company and each of the Company's subsidiaries.

Foreign currency monetary assets and liabilities of the Company and its subsidiaries are translated using the period end closing rate, and non-monetary assets and liabilities, measured at historic cost, are translated at the rate of exchange at the date of the transaction. Foreign currency transactions are translated at the spot exchange rate which is in effect at the date of the transaction. Foreign currency gains or losses arising on translation are included in other operating income (loss) in the income statement.

N) INCOME TAXES

Income tax expense comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case the tax expense is also recognized directly in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates and laws enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred income tax assets and liabilities are provided for using the liability method on temporary differences between the tax bases and carrying amounts of assets and liabilities. Deferred tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the year in which temporary differences are expected to be recovered or settled. Changes to these balances, including changes due to changes in income tax rates, are recognized in profit or loss in the period in which they occur.

Deferred tax assets are recognized to the extent future recovery is probable. Deferred tax assets are reduced to the extent it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

O) GOVERNMENT ASSISTANCE

Government grants are recognized where there is a reasonable assurance that the grant will be received and all attached conditions will be complied with. Government grants are recognized as an offset to expenses over the periods in which the Company recognizes expenses which the grants are intended to compensate. Government grants related to assets are recognized as cost reduction of the assets and reduce depreciation over the expected useful life of the related assets.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

P) INVESTMENT TAX CREDITS

Investment tax credits relating to qualifying scientific research and experimental development expenditures are accrued provided it is probable that the credits will be realized. When recorded, the investment tax credits are accounted for as a reduction of the related expenditures.

Q) INCOME (LOSS) PER COMMON SHARE

Basic income (loss) per common share is computed by dividing the income (loss) by the weighted average number of common shares outstanding during the year. Diluted per share amounts reflect the potential dilution that could occur if the Company's convertible securities and convertible debentures were converted to common shares. Diluted income (loss) per common share is calculated by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effect of all dilutive potential common shares. When the Company is in a net loss position, the conversion of convertible securities and debt is considered to be anti-dilutive.

R) SHARE-BASED PAYMENTS

The Company issues equity-settled share-based awards to eligible employees, directors, officers, and consultants under stock option plans that vest over periods ranging from 2 years to 5 years and have a maximum term of five years. Share-based payments are accounted for using the fair value method, whereby compensation expense related to these programs is recorded in the statement of net income (loss) and comprehensive income with a corresponding increase to contributed surplus. The fair value of options granted is determined using Black-Scholes-Merton pricing model at the grant date and expensed over the vesting period. Expected forfeitures are estimated at the date of grant and subsequently adjusted if further information indicates estimated forfeitures will change. Upon the exercise of the stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

S) CONVERTIBLE DEBENTURES

Certain financial instruments comprise a liability and an equity component. The various components of these instruments are accounted for in equity and other financial liabilities according to their classification, as defined in IAS 32 "Financial Instruments: Disclosure and Presentation". The component classified as other financial liabilities is valued at issuance at the present value (taking into account the credit risk at issuance date) of the future cash flows (including interest and repayment of the nominal value) of an instrument with the same characteristics (maturity, cash flows) but without any option for conversion or redemption in shares. The component classified as equity is defined as the difference between the fair value of the total instrument and the fair value of the financial liability component.

The financial liability component is subsequently measured at amortized cost using the effective interest rate method. The finance costs recognized in respect of the convertible debentures include interest expense based on the coupon rate of the debenture and the accretion of the liability component to the amount that will be payable on redemption.

T) EMPLOYEE FUTURE BENEFITS

The Company accrues its obligations under an employee defined retirement benefit plan and related costs. The cost of retirement benefits earned by employees is determined using the projected unit credit method and management's best estimate of expected retirement ages of employees. The discount rate used is based on the interest rates for high quality corporate bonds. Past service costs relating to plan amendments are accrued and recognized in the year the amendments occur. The Company recognizes actuarial gains and losses in the income statement.

U) PROVISIONS

A provision is recognized when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation, and a reliable estimate of the obligation can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The unwinding of the discount is recognized as a finance cost.

V) TRADE AND OTHER PAYABLES

Trade and other payables, including accruals, are recorded when the Company is required to make future payments as a result of purchases of assets or services. Trade and other payables are recognized initially at fair value and are subsequently measured at amortized cost using the effective interest rate method.

W) FINANCIAL INSTRUMENTS

All financial instruments are measured at initial recognition at fair value plus any transaction costs that are directly attributable to the acquisition of the financial instruments except for transaction costs related to financial instruments classified as at fair value through profit or loss ("FVTPL") which are expensed as incurred. The Company has designated its financial instruments as follows:

- i) Cash and cash equivalents, restricted cash and cash equivalents, and accounts receivable have been classified as loans and receivables and are measured at amortized cost using the effective interest method, less any allowance for uncollectability. The Company recognizes purchase or sale of financial assets using trade date accounting.
- ii) Accounts payable and accrued liabilities, long-term debt, the debt component of convertible debentures, royalties payable, repayable research funding, the royalty financial liability, and the CAAP loan are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method.

X) CONSOLIDATED STATEMENT OF CASH FLOWS

The Company prepares its consolidated statement of cash flows using the indirect method.

Y) FUTURE CHANGES IN ACCOUNTING POLICIES

FINANCIAL INSTRUMENTS DISCLOSURE

In October 2010, the IASB issued amendments to IFRS 7 – Financial Instruments: Disclosures that enhance the disclosure requirements in relation to transferred financial assets. The amendments are effective for annual periods beginning on or after July 1, 2011, with earlier application permitted.

The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

FINANCIAL INSTRUMENTS

The IASB intends to replace IAS 39 – Financial Instruments: Recognition and Measurement ("IAS 39") in its entirety with IFRS 9 – Financial Instruments ("IFRS 9") in three main phases. IFRS 9 will be the new standard for the financial reporting of financial instruments that is principle-based and less complex than IAS 39.

In November 2009 and October 2010, phase 1 of IFRS 9 was issued and amended, respectively, which addressed the classification and measurement of financial assets and financial liabilities. IFRS 9 requires that all financial assets be classified as subsequently measured at amortized cost or at fair value based on the Company's business model for managing financial assets and the contractual cash flow characteristics of the financial assets. Financial liabilities are classified as subsequently measured at amortized cost except for financial liabilities classified as at fair value through profit or loss, financial guarantees, and certain other exceptions. The effective date of IFRS 9 is for annual periods beginning on or after January 1, 2015 (with earlier application permitted). The Company has not yet assessed the impact that this new standard is likely to have on its consolidated financial statements.

CONSOLIDATION

In May 2011, the IASB issued IFRS 10 – Consolidated Financial Statements ("IFRS 10"), which supersedes SIC 12 and the requirements relating to consolidated financial statements in IAS 27 – Consolidated and Separate Financial Statements. IFRS 10 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted under certain circumstances.

IFRS 10 establishes control as the basis for an investor to consolidate its investees and defines control as an investor's power over an investee with exposure, or rights, to variable returns from the investee and the ability to affect the investor's returns through its power over the investee.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In addition, the IASB issued IFRS 12 – Disclosure of Interest in Other Entities (“IFRS 12”) which combines and enhances the disclosure requirements for the Company’s subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The requirements of IFRS 12 include reporting of the nature of risks associated with the Company’s interests in other entities and the effect of those interests on the Company’s consolidated financial statements.

Concurrently with the issuance of IFRS 10, IAS 27, and IAS 28 – Investments in Associates (“IAS 28”) were revised and reissued as IAS 27 – Separate Financial Statements and IAS 28 – Investments in Associates and Joint Ventures to align with the new consolidation guidance.

The Company does not anticipate this new standard to have a significant impact on its consolidated financial statements.

JOINT VENTURES

In May 2011, the IASB issued IFRS 11 – Joint Arrangements (“IFRS 11”), which supersedes IAS 31 – Interest in Joint Ventures and SIC-13 – Jointly Controlled Entities – Non-Monetary Contributions by Venturers. IFRS 11 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted under certain circumstances. Under IFRS 11, joint arrangements are classified as joint operations or joint ventures based on the rights and obligations of the parties to the joint arrangements. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (“joint operators”) have rights to the assets and obligations for the liabilities relating to the arrangement. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (“joint ventures”) have rights to the net assets of the arrangement. IFRS 11 requires that a joint operator recognizes its portion of assets, liabilities, revenues, and expenses of a joint arrangement, while a joint venturer recognizes its investment in a joint arrangement using the equity method.

The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

INCOME TAXES

In December 2010, the IASB issued an amendment to IAS 12 – Income Taxes that provide a practical solution to determining the recovery of investment properties as it relates to the accounting for deferred income taxes. The amendment is effective for annual periods beginning on or after January 1, 2012 with earlier application permitted.

The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements.

FAIR VALUE MEASUREMENT

In May 2011, as a result of a convergence project undertaken by the IASB and the US Financial Accounting Standards Board, to develop common requirements for measuring fair value and for disclosing information about fair value measurements, the IASB issued IFRS 13 – Fair value Measurement (“IFRS 13”). IFRS 13 is effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. IFRS 13 defines fair value and sets out a single framework for measuring fair value which is applicable to all IFRSs that require or permit fair value measurements or disclosures about fair value measurements. IFRS 13 requires that when using a valuation technique to measure fair value, the use of relevant observable inputs should be maximized while unobservable inputs should be minimized.

The Company does not anticipate the application of IFRS 13 to have a significant impact on its consolidated financial statements.

FINANCIAL STATEMENTS PRESENTATION

In June 2011, the IASB issued amendments to IAS 1 – Presentation of Financial Statements (“IAS 1”) that require an entity to group items presented in the Statement of Comprehensive Income on the basis of whether they may be

reclassified to earnings subsequent to initial recognition. For those items presented before taxes, the amendments to IAS 1 also require that the taxes related to the two separate groups be presented separately. The amendments are effective for annual periods beginning on or after July 1, 2012 with earlier adoption permitted.

The Company does not anticipate the application of the amendments to IAS 1 to have a material impact on its consolidated financial statements.

EMPLOYEE BENEFITS

In June 2011, the IASB issued amendments to IAS 19 – Employee Benefits (“IAS 19”) that introduced changes to the accounting for the defined benefit plans and other employee benefits. The amendments include elimination of the options to defer, or recognize in full in earnings, actuarial gains and losses, and instead mandates the immediate recognition of all actuarial gains and losses in other comprehensive income, and requires use of the same discount rate for both the defined benefit obligation and the expected asset return when calculating interest cost. Other changes include modification of the accounting for termination benefits and classification of other employee benefits. The amendments to IAS 19 are effective for annual periods beginning on or after January 1, 2013.

The Company does not anticipate the application of the amendments to IAS 19 to have a material impact on its consolidated financial statements.

3. TRANSITION TO IFRS

The Company has adopted IFRS effective January 1, 2011. Prior to the adoption of IFRS the Company prepared its consolidated financial statements in accordance with Canadian GAAP. The Company’s consolidated financial statements for the year ending December 31, 2011 are the first annual consolidated financial statements that comply with IFRS. The Company’s transition date is January 1, 2010 (the “transition date”) and the Company has prepared its opening IFRS balance sheet at that date. These consolidated financial statements have been prepared in accordance with the accounting policies described in Note 2.

An explanation as to how the transition from Canadian GAAP to IFRS has affected the Company’s financial position, financial performance, and cash flows, is set out in the following reconciliations and explanatory notes that accompany the reconciliations.

A) ELECTED EXEMPTIONS FROM FULL RETROSPECTIVE APPLICATION

In preparing these consolidated financial statements in accordance with IFRS 1 *First-time Adoption of International Financial Reporting Standards* (“IFRS 1”), the Company has applied certain of the optional exemptions from full retrospective application of IFRS. The optional exemptions applied are described below.

i) EMPLOYEE BENEFITS

The Company has elected to recognize all cumulative actuarial gains and losses that existed at the transition date in opening retained earnings for its employee future benefit plan. The application of this exemption did not result in an IFRS transition adjustment to the opening balance sheet on the transition date;

The Company has elected to disclose the amounts required under IAS 19 *Employee Benefits* as the amounts are determined for each accounting period prospectively from the transition date to IFRS;

ii) SHARE-BASED PAYMENT TRANSACTIONS

The Company has elected not to apply IFRS 2 *Share-based Payment* to equity instruments granted that had vested by the date of transition to IFRS;

iii) BUSINESS COMBINATIONS

The Company has elected not to apply IFRS 3 *Business Combinations* retrospectively to business combinations that occurred before the date of transition to IFRS;

3. TRANSITION TO IFRS (CONTINUED)

iv) LEASE

The Company has applied the transitional provisions in IFRIC 4 *Determining whether an Arrangement contains a Lease* and has chosen to determine whether an arrangement existing at the date of transition to IFRS contains a lease on the basis of facts and circumstances existing at that date;

v) COMPOUND FINANCIAL INSTRUMENTS

The Company has elected not to identify separately the amounts within equity that are attributable to the equity and liability elements of convertible debentures issued prior to the date of transition where the liability component is no longer outstanding at the date of transition to IFRS;

vi) BORROWING COSTS

The Company has elected to apply the transitional provisions of IFRS 23 *Borrowing Costs* and will only commence the capitalization of borrowing costs that are directly attributable to the acquisition and construction of qualifying assets for which the commencement date is subsequent to the date of transition to IFRS.

B) MANDATORY EXCEPTIONS TO RETROSPECTIVE APPLICATION

In preparing these consolidated financial statements in accordance with IFRS 1, the Company has applied certain mandatory exceptions from full retrospective application of the IFRS. The mandatory exception that is applicable to the Company on its conversion to IFRS is described below.

ESTIMATES

Hindsight was not used to create or revise estimates. The Company's estimates, in accordance with IFRS at the date of transition, are consistent with estimates made for the same date in accordance with previous Canadian GAAP.

C) RECONCILIATION OF THE COMPANY'S EQUITY REPORTED IN ACCORDANCE WITH CANADIAN GAAP TO ITS EQUITY IN ACCORDANCE WITH IFRS

Reconciliation of the Company's equity at January 1, 2010

	Previous Canadian GAAP \$	Effect of transition to IFRS \$	2010 Correction \$	IFRS \$
ASSETS				
Current Assets				
Cash	115,502			115,502
Accounts receivable	151,144			151,144
Inventories	516,821			516,821
Prepaid expenses and deposits	62,309			62,309
	845,776			845,776
Non-Current Assets				
License	27,000			27,000
Property and equipment	1,897,878			1,897,878
	1,924,878			1,924,878
TOTAL ASSETS	2,770,654			2,770,654
LIABILITIES AND SHAREHOLDERS' DEFICIENCY				
Current Liabilities				
Accounts payable and accrued liabilities	846,538			846,538
Current portion of long-term debt	138,806			138,806
Royalties interest payable	758,436			758,436
Current portion of deferred royalty revenue	(iii) 60,000		(60,000)	-
Current portion of royalty financial liability	(iii) -		49,857	49,857
SGGF legal fees	314,983			314,983
	2,118,763		(10,143)	2,108,620
Non-Current Liabilities				
Deferred royalty revenue	(iii) 220,422		(220,422)	-
Royalty financial liability	(iii) -		329,434	329,434
Employee future benefits obligation	136,786			136,786
Long-term debt	1,227,426			1,227,426
Convertible debentures	440,000			440,000
	2,024,634		109,012	2,133,646
Shareholders' Deficiency				
Share capital	5,479,202			5,479,202
Equity component of convertible debentures	(ii) 60,000	(15,000)		45,000
Contributed surplus	(i) 478,945	(192,731)		286,214
Deficit	(7,390,890)	207,731	(98,869)	(7,282,028)
	(1,372,743)	-	(98,869)	(1,471,612)
TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIENCY	2,770,654	-	-	2,770,654

3. TRANSITION TO IFRS (CONTINUED)

Reconciliation of the Company's equity at December 31, 2010

	Previous Canadian GAAP \$	Effect of transition to IFRS \$	2010 Correction \$	IFRS \$
ASSETS				
Current Assets				
Cash	186,690			186,690
Accounts receivable	570,362			570,362
Inventories	279,425			279,425
Prepaid expenses and deposits	70,230			70,230
	1,106,707			1,106,707
Non-Current Assets				
License	24,000			24,000
Property and equipment	1,689,052			1,689,052
	1,713,052			1,713,052
TOTAL ASSETS	2,819,759			2,819,759
LIABILITIES AND SHAREHOLDERS' DEFICIENCY				
Current Liabilities				
Accounts payable and accrued liabilities	862,163			862,163
Current portion of long-term debt	146,426			146,426
Royalties interest payable	378,051			378,051
Current portion of deferred royalty revenue	(iii) 60,000		(60,000)	-
Current portion of royalty financial liability	(iii) -		63,360	63,360
Convertible debentures	467,500			467,500
Current portion of repayable research funding	12,500			12,500
	1,926,640		3,360	1,930,000
Non-Current Liabilities				
Deferred royalty revenue	(iii) 166,198		(166,198)	-
Royalty financial liability	(iii) -		266,075	266,075
Employee future benefits obligation	160,187			160,187
Long-term debt	1,081,000			1,081,000
Repayable research funding	37,500			37,500
	1,444,885		99,877	1,544,762
Shareholders' Deficiency				
Share capital	5,770,858			5,770,858
Equity component of convertible debentures	(ii) 60,000	(15,000)		45,000
Contributed surplus	(i) 507,188	(159,743)		347,445
Deficit	(6,889,812)	174,743	(103,237)	(6,818,306)
	(551,766)	-	(103,237)	(655,003)
TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIENCY	2,819,759		-	2,819,759

EFFECT OF TRANSITION TO IFRS

i) Share-based payments

The Company recognizes share-based compensation expense for the fair value of stock options granted under Canadian GAAP and IFRS. However, the timing and amount of expense may differ.

Under Canadian GAAP, if the expected life of an award that vests over a number of periods does not differ significantly, the award can be treated as one grant and the related compensation can be recognized on a straight-line basis. Additionally, a company could elect either to estimate the expected forfeiture rate at the date of grant or recognize forfeitures as they occur. Under IFRS, when an award vests over a number of periods, each vesting tranche is treated as a separate grant with a separate vesting date and fair value. The application of an estimated forfeiture rate for stock option grants is required.

The Company previously recognized forfeitures as they occurred and recognized compensation expense on a straight-line basis. On the date of transition, the Company recognized an adjustment to decrease the contributed surplus balance by \$21,689; at December 31, 2010, the Company recognized additional adjustments to increase the contributed surplus balance by \$32,988. These entries have been recorded directly through equity.

Under IFRS 2 "Share-based Payment", the Company cannot make a subsequent adjustment to equity after vesting date. However, the requirement does not preclude the Company from recognizing a transfer within equity. On the date of transition, the Company has transferred from contributed surplus to deficit, share-based payments in the amount of \$171,042, relating to stock options that were fully vested and expired prior to January 1, 2010. The transfer was made through equity.

ii) Income taxes

The Company issued convertible debentures during the year ended December 31, 2009. Under Canadian GAAP, it is expected that a compound instrument can be settled without the incidence of tax. The tax basis of the liability component is considered equal to its carrying amount and no temporary difference with respect to deferred tax arises. Under IFRS, the tax base of the liability component is equal to the sum of the liability and equity components which results in a taxable temporary difference. As a result, the Company recorded a deferred tax liability on the date of transition in the amount of \$15,000 of which the offset was charged directly against the equity component of the convertible debentures. Concurrent with this transaction, the Company also recognized a deferred tax asset on previously unrecognized deductible temporary differences. This entry has been recorded directly through equity on transition. No additional adjustments for this difference were made at December 31, 2010.

Under Canadian GAAP, when an asset is transferred between enterprises within a consolidated group, a deferred tax asset should not be recognized in the consolidated financial statements for a temporary difference arising between the tax basis of the asset in the buyer's tax jurisdiction and its cost as reported in the consolidated financial statements. Under IFRS, a deferred tax asset is recognized for the difference in the tax basis of the buyer and the cost as reported in the consolidated financial statements as a result of intra-group transfers. On the date of transition, this results in additional tax effected deductible temporary differences of \$656,159; however, as it is not probable that taxable profit will be available against which the deductible temporary differences can be utilized, a deferred tax asset has not been recognized.

2010 CORRECTION

iii) Royalty financial liabilities

On December 28, 2005, the Company sold a 2.285% royalty interest in the Company's future sales and licensing of active ingredients, animal health, and CeaProve® products for \$457,000. Maximum royalties payable are two times the amount invested or \$914,000. Under Canadian GAAP, the Company accounted for this royalty interest offering as a revenue transaction. The proceeds received were recorded as deferred revenue and were recognized into income on a 1/2 basis consistent with the related royalty expense. Under Canadian GAAP, the Company should instead have accounted for the transaction as a financial liability.

3. TRANSITION TO IFRS (CONTINUED)

Under IFRS, the proceeds received from this royalty interest offering should also be accounted for as a financial liability. The Company decided to correct its prior period comparative financial information under its first issuance of annual audited consolidated financial statements prepared in accordance with IFRS. On the date of transition, the Company reclassified \$280,422 of deferred revenue to a royalty financial liability. The royalty financial liability was measured based on a discount rate of approximately 15% which is derived by taking into account future estimated repayments to satisfy the financial liability. The increase in the liability at January 1, 2010 of \$98,869 and at December 31, 2010 of \$103,237 was recorded directly through equity. See note 9(e).

D) RECONCILIATION OF THE COMPANY'S NET INCOME AND COMPREHENSIVE INCOME REPORTED IN ACCORDANCE WITH CANADIAN GAAP TO ITS NET INCOME AND COMPREHENSIVE INCOME IN ACCORDANCE WITH IFRS

Reconciliation of the Company's net income and comprehensive income for the December 31, 2010

		Previous Canadian GAAP \$	Effect of transition to IFRS \$	2010 Correction \$	IFRS \$
Revenue		5,576,636			5,576,636
Cost of goods sold	(i)	3,041,469	18,735		3,060,204
Gross margin		2,535,167	(18,735)		2,516,432
Research and product development	(i)	764,351	9,708		774,059
General and administration	(i)	1,274,467	4,545		1,279,012
Sales and marketing		69,513			69,513
Finance costs	(ii)	198,499		4,368	202,867
Income from operations	(i)(ii)	228,337	(32,988)	(4,368)	190,981
Other operating loss		(29,964)			(29,964)
Write-off of property and equipment		(12,278)			(12,278)
SGGF legal fees		314,983			314,983
Net income and comprehensive income for the year		501,078	(32,988)	(4,368)	463,722
Net income per common share:					
Basic		0.01			0.01
Diluted		0.01			0.01
Weighted average number of common shares outstanding		53,219,621			53,219,621

The following explanatory notes relating to the Company's reconciliations of net income and comprehensive income from Canadian GAAP to IFRS should be read in conjunction with the Company's explanatory notes relating to its reconciliations of equity.

EFFECT OF TRANSITION TO IFRS

i) Share-based payments

As a result of differences in accounting treatment between Canadian GAAP and IFRS the Company increased share-based payment expenses by \$32,988 for the year ended December 31, 2010.

2010 CORRECTION

ii) Finance costs

Royalty financial liability

The Company has increased interest expenses from the unwinding of the discount on the royalty financial liability in the amount of \$4,368 for the year ended December 31, 2010.

E) STATEMENTS OF CASH FLOWS

There were no significant changes to the presentation of cash flows as reported under Canadian GAAP to IFRS, with the exception of the Company reporting interest paid directly in the statement of cash flows under IFRS, whereas under Canadian GAAP, it was disclosed as supplementary information to the statement of cash flows.

4. INVENTORIES

The Company had the following inventory at the end of each reporting period:

	December 31 2011 \$	December 31 2010 \$	January 1 2010 \$
Raw materials	251,010	224,262	218,604
Work in progress	227,888	15,996	135,026
Finished goods	212,513	39,167	163,191
	691,411	279,425	516,821

Inventories expensed to cost of goods sold during the year ended December 31, 2011 is \$2,475,938 (year ended December 31, 2010 – \$2,980,103).

5. PROPERTY AND EQUIPMENT

Cost at	Equipment not available for use \$	Manufacturing Equipment \$	Office Equipment \$	Computer Equipment \$	Leasehold Improvements \$	Total \$
January 1, 2010	176,431	2,635,342	75,861	240,070	120,014	3,247,718
additions	–	80,029	419	10,294	350	91,092
write-offs	–	(16,949)	–	–	–	(16,949)
December 31, 2010	176,431	2,698,422	76,280	250,364	120,364	3,321,861
additions	31,319	86,540	1,001	7,029	–	125,889
write-offs	–	–	–	–	–	–
December 31, 2011	207,750	2,784,962	77,281	257,393	120,364	3,447,750
Accumulated Depreciation at						
January 1, 2010	–	1,063,270	54,135	152,878	79,557	1,349,840
depreciation	–	223,878	4,387	27,189	32,186	287,640
write-offs	–	(4,671)	–	–	–	(4,671)
December 31, 2010	–	1,282,477	58,522	180,067	111,743	1,632,809
depreciation	–	263,031	3,586	21,706	5,959	294,282
write-offs	–	–	–	–	–	–
December 31, 2011	–	1,545,508	62,108	201,773	117,702	1,927,091
Carrying value at						
December 31, 2011	207,750	1,239,454	15,173	55,620	2,662	1,520,659
December 31, 2010	176,431	1,415,945	17,758	70,297	8,621	1,689,052
January 1, 2010	176,431	1,572,072	21,726	87,192	40,457	1,897,878

Depreciation expense allocation for the following periods:

	Cost of goods sold \$	Inventory \$	G&A \$	Total \$
Year ending December 31, 2011	227,150	34,958	32,174	294,282
Year ending December 31, 2010	249,764	3,649	34,227	287,640

6. LICENSE

During the year ended December 31, 2011, the Company has entered into a new licensing agreement with the University of Guelph for an exclusive variety of a mint plant. This agreement replaced the agreement the Company entered during the year ended December 31, 2008. The Company paid a licensing fee of \$30,000 in 2008 and amortized the license over 10 years. Amortization of \$3,000 has been included in general and administration expense in each of the years ended December 31, 2009, 2010, and 2011.

The Company paid an additional licensing fee of \$15,000 in 2011 in accordance with the new agreement and has capitalized this amount under License. The new licensing agreement is effective for 10 years. The remaining 2008 unamortized license fee and the additional 2011 license fee will be amortized prospectively over the new 10-year term.

Cost of License	\$
Balance – January 1, 2010	30,000
Additions	–
Balance – December 31, 2010	30,000
Additions	15,000
Balance – December 31, 2011	45,000
Accumulated amortization	
Balance – January 1, 2010	3,000
Amortization	3,000
Balance – December 31, 2010	6,000
Amortization	3,000
Balance – December 31, 2011	9,000
Net book value	
December 31, 2011	36,000
December 31, 2010	24,000
January 1, 2010	27,000

The amortization expense for years ended December 31, 2011 and 2010 is presented under general and administration expense.

7. LONG-TERM DEBT

	December 31 2011 \$	December 31 2010 \$	January 1 2010 \$
Loan payable at \$17,384 per month, principal and interest at 5.49%, secured by a general security agreement, due January, 2013.	1,081,000	1,227,426	1,366,232
Less current portion	154,465	146,426	138,806
	926,535	1,081,000	1,227,426

Interest expense is presented under finance costs for the following periods:

Year Ended December 31, 2011	59,842
Year Ended December 31, 2010	69,808

In the event of default of any terms and conditions of the loan and enforcement of these terms and conditions by the lender, the current interest rate will be cancelled from the date of enforcement of the action. If such a circumstance were to arise, the interest rate would become 7.49% and would result in monthly payments of \$18,925. The security agreement also includes a standard subjective acceleration clause for material adverse events. The Company is in compliance with all terms and conditions.

8. CONVERTIBLE DEBENTURES

On December 31, 2009, the Company issued secured convertible debentures for cash of \$500,000. The debentures incurred interest at 8% per annum, matured on December 31, 2011, and were convertible at any time at a price of \$0.10 per common share at the option of the holder.

The convertible debentures contained both liability and equity components. The Company allocated the total proceeds received between the liability and equity components of the convertible debentures using the residual method, based on an interest rate of 15%, which is the estimated cost of borrowing at which the Company could borrow similar debt without a conversion feature.

In December 2011, the Company issued 3,700,000 common shares totaling \$370,000 and paid \$130,000 in cash for the full settlement of the convertible debentures.

	December 31 2011 \$	December 31 2010 \$	January 1 2010 \$
Total value of convertible debentures	–	512,500	485,000
Equity component	–	60,000	60,000
Deferred tax on equity component	–	(15,000)	(15,000)
	–	45,000	45,000
Liability component	–	467,500	440,000

Interest and accretion expenses are presented under finance costs for the following periods:

	Interest expense	Accretion
Year Ended December 31, 2011	40,000	32,500
Year Ended December 31, 2010	41,096	27,500

9. ROYALTIES PAYABLE

a) In the year ended December 31, 1999, the Company received financial assistance in the amount of \$164,882 for the research and development of new products, patents, and markets. The Company was obligated to pay a 5% royalty (to a maximum of two times the financial assistance received) on sales generated from products developed using these funds. The portion of this obligation paid or accrued as December 31, 2011 was \$329,764 (2010 – \$329,764). During the year ended December 31, 2011, \$nil (2010 – \$111,844) was repaid and the balance of royalties payable under this agreement as at December 31, 2011 is \$nil (2010 – \$nil).

b) In the year ended December 31, 2004, the Company's wholly-owned subsidiary, Ceapro Technology Inc. (CTI), received a commitment for financial assistance totaling \$250,000 for pre-market activities of CeaProve® (a health and wellness product) upon completion of project objectives as outlined and agreed to by both parties. As at December 31, 2011, \$225,000 (2010 – \$225,000) of this commitment has been received and the remaining \$25,000 was decommitted. CTI is obligated to pay a royalty (to a maximum of two times the financial assistance received) on sales generated from CeaProve® on the following basis: 0% of revenues earned to December 31, 2005, 2.5% of revenues earned to December 31, 2006, and 5% thereafter until repaid. No royalties have been paid or accrued during the current or prior years. CTI has repaid at December 31, 2011 \$nil (2010 – \$nil) of this obligation. Upon completion of the repayment of the financial assistance received, CTI will be required to repay \$19,750 advanced during the year ended December 31, 2002. The portion of this obligation paid or accrued as at December 31, 2011 was \$nil (2010 – \$nil).

c) In the year ended December 31, 2003, the Company completed a Royalty Income Unit offering through the terms described in an Offering Memorandum. Each royalty interest has a right to receive royalties equal to 0.00001% from the sale or licensing of the Company's active ingredients and animal health products, to a maximum cumulative amount of \$2.08 per unit. Proceeds from the offering of \$516,348 (before related expenses) represent the sale of a 5.163% royalty interest in the Company's future sales and licensing of active ingredients and animal health products. Maximum royalties payable are two times the amount invested or \$1,032,695. The portion of this obligation paid or accrued at December 31, 2011 was \$1,032,695 (2010 – \$1,032,695). During the year ended December 31, 2011, the Company repaid \$170,536 through cash payments (2010 – \$93,307 by issuing 1,036,744 common shares and \$56,849 through cash payments). The balance of royalties payable under this offering as at December 31, 2011 is \$nil (2010 – \$170,536).

d) In the year ended December 31, 2003, the Company sold a 1.418% royalty interest in the Company's future sales and licensing of active ingredients and animal health products for \$141,796. In the year ended December 31, 2004, the Company sold an additional 1.724% royalty interest in the future sales and licensing of active ingredients and animal health products for \$172,401. The cumulative royalty interest of 3.142% for \$314,197 results in combined maximum royalties of two times the amount invested or \$628,394. The portion of this obligation paid or accrued at December 31, 2011 was \$628,394 (2010 – \$628,394). During the year ended December 31, 2011, the Company repaid \$40,903 through cash payments (2010 – \$94,908 by issuing 1,054,533 common shares and \$13,634 through cash payments). The balance of royalties payable under this offering as at December 31, 2011 is \$nil (2010 – \$40,903).

e) On December 28, 2005, the Company sold a 2.285% royalty interest in the Company's future sales and licensing of active ingredients, animal health, and CeaProve® products for \$457,000. Maximum royalties payable are two times the amount invested or \$914,000. The portion of this obligation paid or accrued as at December 31, 2011 was \$570,157 (2010 – \$458,775). During the year, the Company repaid \$244,628 through cash payments (2010 – \$82,345 by issuing 914,947 common shares and \$35,947 through cash payments). The balance of royalties payable under this offering as at December 31, 2011 totaled \$33,366 (2010 – \$166,612).

f) In the year ended December 31, 2005, the Company and its wholly-owned subsidiary, Ceapro Veterinary Products Inc. (CVP), received a commitment for financial assistance totaling \$362,250 for product innovation development in the area of Veterinary Therapeutics and Active Ingredients. As at December 31, 2011, \$362,250 (2010 – \$362,250) of the commitment has been received. The Company and CVP are obligated to pay a 2.5% royalty to a maximum of \$75,000 per quarter (to a maximum of two times the financial assistance received or \$724,500) on sales generated from products developed using these funds. These royalties commenced when the royalty payments on investment agreements in note 9(a) were fully satisfied. The portion of the obligation paid or accrued at December 31, 2011 was \$234 (2010 – \$nil).

g) In the year ended December 31, 2005, the Company's wholly-owned subsidiary, Ceapro Technology Inc. (CTI), received a commitment for financial assistance totaling \$800,000 for pre-market activities of CeaProve® (a health and wellness product) upon completion of project objectives as outlined and agreed to by both parties. As at December 31, 2011, \$510,000 of this commitment has been received (2010 – \$510,000) and the remaining \$290,000 has been decommitted. CTI is obligated to pay a royalty (to a maximum of one and a half times the financial assistance received or \$765,000) on sales of CeaProve® on the following basis: 0% of net sales and net sub-licensing revenues earned until royalty payments have been fully satisfied under the investment agreement in note 9(b), and 5% thereafter until repaid to a maximum of \$125,000 per quarter. No royalties have been incurred during the current year. The portion of this obligation paid or accrued as at December 31, 2011 was \$nil (2010 – \$nil).

As the funding received in items b), f) and g) above is contingently repayable, it constitutes a liability that is recognized initially at fair value and subsequently at amortized cost using the effective interest method. As the initial fair value was estimated to be negligible, funding received was recorded as revenue and no liability was recorded. Management updates the estimate of future cash flows required under these agreements at each reporting date to assess whether the expected repayments constitute a significant liability.

10. DEFERRED REVENUE

During the year ended December 31, 2011, the Company received \$750,000 under a non-repayable capital expenditure grant agreement with Alberta Innovates Bio Solutions (AI Bio Solutions) (note 24). This amount is presented as deferred revenue and restricted cash and cash equivalents on the balance sheet. At December 31, 2011, the Company has not expended any amount of this grant.

Deferred revenue also consists of \$561,024 for prepaid sales orders and \$10,500 for a research grant advanced in excess of expenditures made.

11. EMPLOYEE FUTURE BENEFITS OBLIGATION

The Company has an unfunded, non-registered, non-indexed defined retirement benefit plan for an officer. The retirement benefit is two months' salary for each year the employee is employed by the Company.

Management is required to make an estimate regarding the discount rate used to determine the accrued benefit obligation. This estimate is of a long-term nature, which is consistent with the nature of the employee future benefits. The discount rate used to determine the accrued benefit obligation as at December 31, 2011 was 4.19% (December 31, 2010 – 4.19%).

Accrued benefit obligation	Year Ended December 31 2011 \$	Year Ended December 31 2010 \$
Unfunded balance, beginning of year	160,187	136,786
Current service cost	19,983	17,297
Interest costs on accrued benefit obligation	7,132	6,104
	187,302	160,187

Elements of defined benefit costs recognized in the year	Year Ended December 31 2011 \$	Year Ended December 31 2010 \$
Current service cost	19,983	17,297
Interest cost on accrued benefit obligation	7,132	6,104
	27,115	23,401

Defined benefit costs have been presented under research and product development expenses in the consolidated statements of net income for the year.

12. SHARE CAPITAL

A) AUTHORIZED

- i) Unlimited number of Class A voting common shares. Class A common shares have no par value.
- ii) Unlimited number of Class B non-voting common shares. There are no issued Class B shares.

B) ISSUED – CLASS A COMMON SHARES

	Year ended December 31, 2011		Year Ended December 31, 2010	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Balance at beginning of the year	54,988,039	5,770,858	51,710,063	5,479,202
Changes during the year				
Shares issued for debt	5,290,909	545,000	3,277,976	291,656
Balance at end of the year	60,278,948	6,315,858	54,988,039	5,770,858

In December 2011, the Company issued 3,700,000 common shares totaling \$370,000 for the settlement of the convertible debentures (note 8).

During the year ended December 31, 2011, the Company's directors exchanged debt obligations totaling \$175,000 into 1,590,909 common shares of the Company.

During the year ended December 31, 2010, the Company issued 3,006,224 common shares for the settlement of royalty payable obligations totaling \$270,560 and 271,752 common shares for full settlement of interest due on convertible debentures in the amount of \$21,096.

These non-cash transactions have been excluded from the consolidated statement of cash flows.

C) CONTRIBUTED SURPLUS

The following table summarizes the changes in contributed surplus:

	2011 \$	2010 \$
Balance at beginning of year	347,445	286,214
Share-based payments (note 12 (d))	50,186	61,231
Balance at end of year	397,631	347,445

D) STOCK OPTIONS AND SHARE-BASED PAYMENTS

The Company has granted stock options to eligible employees, directors, officers, and consultants under stock option plans that vest over periods ranging from two years to five years and have a maximum term of five years.

The Company accounts for options granted under these plans in accordance with the fair value based method of accounting for share-based payments. In the current year, the Company granted 400,000 (2010 – 650,000) stock options. The application of the fair value based method requires the use of certain assumptions regarding the risk-free market interest rate, expected volatility of the underlying stock, and life of the options. The weighted average risk-free rate used in 2011 was 2.10% (2010 – 2.29%), the weighted average expected volatility was 127% (2010 – 126%) which was based on prior trading activity of the Company's shares, the weighted average expected life of the options was 5 years (2010 – 5 years), the weighted average share price was \$0.10 (2010 – \$0.08), the weighted average exercise price was \$0.15 (2010 – \$0.10), and the expected dividends were nil (2010 – nil). The weighted average grant date fair value of options granted during the year were \$0.11 (2010 – \$0.06) per option. The share-based payments expense recorded during the current year relating to options granted in 2011, 2010, 2009, 2008, and 2007 was \$50,186 (2010 – \$61,231).

12. SHARE CAPITAL (CONTINUED)

A summary of the status of the Company's stock options at December 31, 2011 and 2010 and changes during the years ended on those dates is as follows:

	2011		2010	
	Number of Options	Weighted Average Exercise Price \$	Number of Options	Weighted Average Exercise Price \$
Outstanding at beginning of year	3,105,000	0.16	2,485,000	0.18
Granted	400,000	0.15	650,000	0.10
Expired or forfeited	(335,000)	0.22	(30,000)	0.12
Outstanding at end of year	3,170,000	0.16	3,105,000	0.16
Exercisable at end of year	2,713,333	0.16	2,261,667	0.18

E) STOCK OPTIONS OUTSTANDING ARE AS FOLLOWS:

Fair Value at grant date \$	Exercise Price \$	Year of Expiration	Weighted Average Contractual Life Remaining (years)	December 31 2011 Number of Options	December 31 2010 Number of Options	January 1 2010 Number of Options
0.11	0.15	2016	4.5	400,000	–	–
0.06	0.10	2015	3.7	570,000	650,000	–
0.10	0.13	2014	2.5	900,000	900,000	900,000
0.08	0.12	2013	1.7	600,000	630,000	660,000
0.15	0.25	2013	1.0	210,000	210,000	210,000
0.19	0.28	2012	0.7	390,000	390,000	390,000
0.22	0.30	2012	0	100,000	100,000	100,000
0.20	0.30	2011	0	–	75,000	75,000
0.20	0.27	2011	0	–	150,000	150,000
			2.4	3,170,000	3,105,000	2,485,000

13. CAAP LOAN

The Company entered into Canadian Agricultural Adaptation Program ("CAAP") repayable contribution agreements for total possible funding of \$1,339,625 receivable over the period from October 7, 2010 through September 30, 2012. Receipt of the funding is contingent upon the Company's compliance with the terms of the agreement which includes, among other things, the making of formal request for funds supported by activity updates and expenditure reports.

As the contributions are non-interest bearing, the fair value at inception is estimated as the present value of the principal payments required, discounted using the prevailing market rates of interest for a similar instrument estimated to be 15% per annum. The difference between the fair value of the contributions and the cash received is accounted for as a government grant.

The balance of repayable contribution is derived as follows:

	2011 \$
Opening balance January 1,	–
Funding received or receivable	123,081
Grant revenue recognized	(69,990)
Accretion of discount	4,341
	<u>57,432</u>

Principal repayment required for amount received from inception to December 31, 2011 is \$15,385 annually from 2013 through 2020.

Subsequent to December 31, 2011, the Company received additional funding in the amount of \$107,104.

14. SALES

During the year ended December 31, 2011, the Company had export sales to five customers and distributors of the Company's products in the amount of \$5,753,038 (2010 – \$5,517,077) with each individual customer accounting for 10% or more of the Company's sales. The Company is therefore dependent on those customers and distributors to maintain and expand the volume of product sales to existing and new customers.

15. RELATED PARTY TRANSACTIONS

Related party transactions during the periods not otherwise disclosed in these consolidated financial statements are as follows:

	Year Ended December 31	
	2011 \$	2010 \$
Royalties earned by employees and directors	22,109	21,951
Amounts payable to employees and directors included in royalties payable	6,318	27,758
Royalties payable to employees and directors converted to common shares	–	71,898
Convertible debentures owned by officers and directors	–	70,000
Interest earned in convertible debentures by officers and directors	5,600	5,753
Convertible debentures interest payable to officers and directors converted to common shares	–	2,953
Key management salaries, short-term benefits, consulting fees and director fees	484,861	437,360
Key management personnel share based payments	48,595	35,736
Director fees converted by directors to common shares	175,000	–
Conversion of principal amount of convertible debentures to common shares by officers and directors	70,000	–
Amounts payable to directors	175,000	140,000

These transactions are in the normal course of operations and are measured at the amount of consideration established and agreed to by the related parties.

16. OTHER OPERATING LOSSES (INCOME)

	2011 \$	2010 \$
Foreign exchange losses	31,609	27,641
Other (income) expenses	(24,271)	2,323
	7,338	29,964

17. FINANCE COSTS

	2011 \$	2010 \$
Interest on royalty financial liability	43,663	64,353
Interest on long-term loan	59,842	69,808
Interest on convertible debentures	40,000	41,096
Accretion of convertible debentures	32,500	27,500
Accretion of CAAP loan	4,341	-
Bank charges	462	110
	180,808	202,867

18. INCOME TAXES**A) NON-CAPITAL LOSSES**

The Company has accumulated non-capital losses carried forward for federal income tax purposes of approximately \$12,418,200 and for provincial income tax purposes of approximately \$12,265,500, the benefit of which has not been reflected in these consolidated financial statements. These losses may be applied against future taxable income within the limitations prescribed by the Income Tax Act and expire as follows:

	Federal \$	Alberta \$
2015	293,400	293,400
2026	651,500	651,500
2027	2,730,300	2,730,300
2028	4,770,200	4,617,500
2029	1,697,300	1,697,300
2030	1,512,300	1,512,300
2031	763,200	763,200
Total	12,418,200	12,265,500

B) CAPITAL LOSSES

The Company has accumulated capital losses of approximately \$6,807,000, which can be carried forward indefinitely to offset future capital gains.

C) SCIENTIFIC RESEARCH AND EXPERIMENTAL DEVELOPMENT (SR & ED)

The Company has accumulated an SR & ED expenditure pool of approximately \$1,366,500, which can be carried forward indefinitely to be applied against future taxable income.

The Company has accumulated SR & ED investment tax credits of approximately \$213,000. These credits may be applied against future federal income taxes payable and expire in 2029.

D) UNRECOGNIZED DEFERRED TAX ASSET

A deferred income tax asset reflects the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Components of the Company's unrecognized deferred income tax asset are as follows:

	2011 \$	2010 \$
INCOME TAX EFFECT OF DEDUCTIBLE TEMPORARY DIFFERENCES:		
Non-capital losses and SR & ED expenditures carried forward	3,431,000	3,403,000
Net capital losses carried forward	851,000	851,000
SR & ED investment tax credits	213,000	79,000
Undepreciated capital cost for tax purposes in excess of net book value	623,000	818,000
Deferred revenue recognized for tax purposes	43,000	57,000
Employee future benefit expense not recognized for tax purposes	47,000	40,000
Unrecognized deferred tax assets	5,208,000	5,248,000

For consolidated financial statement purposes, no deferred income tax asset has been recorded at December 31, 2011 and 2010 as it is not likely to be realized.

The Company has reflected the income tax effect of deductible temporary differences on the basis of the expected tax consequences that would follow from the manner in which the recovery or settlement of the carrying amount of assets and liabilities are expected. As a result of past asset transfers within the consolidated group, should the Company settle certain assets in a different manner, the Company would have additional tax effected deductible temporary differences relating to the tax cost base of certain tax assets in the amount of \$656,159 which is not reflected above.

E) INCOME TAX RECONCILIATION

The Company's consolidated income tax position comprises tax benefits and provisions arising from the respective tax positions of its taxable entities. The Company's income tax provision differs from that calculated by applying statutory rates for the following reasons:

	2011 \$	2010 \$
Income taxes based on federal and provincial statutory income tax rate of 26.5% (2010 – 28%)	153,057	129,842
Tax effect of expenses that are not deductible	24,350	34,815
Tax effect of government grant revenue not taxable	(17,397)	–
Change in income tax rates	(9,057)	(17,642)
Change in investment tax credits	(134,320)	(78,660)
Other	22,895	(32,935)
Current year items where deferred tax asset not recognized	(39,528)	(35,420)
	–	–

19. SEGMENTED INFORMATION

The Company operates in one industry segment, which is the active ingredient product technology industry. The majority of the revenue is derived from sales in North America. All the assets of the Company, which support the revenues of the Company, are located in Canada. The distribution of revenue by location of customer is as follows:

	2011 \$	2010 \$
United States	4,150,970	4,109,206
Other	1,548,007	1,467,006
Canada	87,197	424
	5,786,174	5,576,636

20. CONTINGENCIES AND COMMITMENTS

a) During the year ended December 31, 2011, the Company and its wholly-owned subsidiary, Ceapro Veterinary Products Inc. were served with a statement of claim from AVAC Ltd. alleging damages of \$724,500 pursuant to a product development agreement. The Company and Ceapro Veterinary Products Inc., have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However, at this time, the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

b) During the year ended December 31, 2008, the Company recorded a provision of \$741,283 for disputed legal fees related to a previous litigation case that was settled with all defendants in 2009. The terms of the legal settlement were fully satisfied in 2009. During the second quarter of 2009, the Company was advised by one legal firm that they did not intend to pursue collection of their previously billed legal fees. The amount of the fees was \$426,300 and this was recorded as a recovery in the second quarter of 2009.

During the second quarter of 2010, management reviewed the exposure of the remaining provision totaling \$314,983. Based upon the review by management at June 30, 2010 with its legal counsel and the circumstances applicable at that time, management believes the Company is no longer exposed to the remaining accrued legal fees liability and the amount of \$314,983 was recorded as a recovery in the year ended December 31, 2010.

c) During the year ended December 31, 2008, the Company entered into a licensing agreement with the University of Guelph for an exclusive variety of a mint plant. During the year ended December 31, 2011, the Company has entered into a new licensing agreement with the University of Guelph for additional market rights for the exclusive variety of a mint plant (note 6).

In accordance with the new agreement, there are future minimum royalty payments of \$10,000 per annum starting in 2012 for royalty payments which will be calculated as 5% of net sales from products derived from the mint plants. The agreement is an executory contract and therefore all royalty payments under the contract will be recognized as they become due.

d) In the normal course of operations, the Company may be subject to litigation and claims from customers, suppliers, and former employees. Management believes that adequate provisions have been recorded in the accounts where required. Although it is not possible to estimate the extent of potential costs, if any, management believes that the ultimate resolution of such contingencies would not have a material adverse effect on the financial position of the Company.

21. OPERATING LEASE

The Company paid \$348,357 in 2011 (2010 – \$321,364) under operating lease. These amounts were recorded as follows: general and administration expenses of \$89,664 (2010 – \$86,874), research and development expenses of \$13,718 (2010 – \$nil), and cost of goods sold of \$244,975 (2010 – \$234,490).

The Company is committed to future annual payments under operating leases for manufacturing facilities and office space. All operating leases expire by September 30, 2012. Total lease commitments from January 1, 2012 until September 30, 2012 are \$156,092.

22. FINANCIAL INSTRUMENTS

The fair value of cash and cash equivalents, restricted cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and royalties interest payable approximate their carrying amount due to their short-term nature. The fair value of long-term debt is estimated to approximate its carrying value because the interest rate does not differ significantly from current interest rates for similar types of borrowing arrangements. The liability component of convertible debentures was calculated using a 15% discount rate. Management considers that no events have occurred subsequent to the inception of this financing arrangement that would indicate that the fair value differs substantially from carrying value.

The Canadian Agricultural Adaptation Program (“CAAP”) loan is recorded at the amount drawn under the agreement, discounted using the prevailing market rate of interest for a similar instrument, which represents the estimated fair value of the obligation.

The repayable research funding is recorded at the amount drawn under the agreement which represents the estimated fair value of the obligation plus the deferred interest benefit that will be recognized systematically over the term of the loan.

The fair value of the CAAP loan and the repayable research funding are not materially different from their carrying amounts as funding received has been discounted using an estimate of a market rate of interest and is being accreted back to its nominal amount.

The royalty financial liability was estimated using a discount rate that results from the estimated future repayment of that obligation. As there has been no significant change in estimated future repayments, and as the estimated discount rate also approximates the Company’s estimated cost of capital for similar borrowing arrangements, management believes the carrying amount of this obligation does not differ significantly from its fair value.

The Company has exposure to credit, liquidity, and market risk as follows:

A) CREDIT RISK

ACCOUNTS RECEIVABLE

The Company makes sales to customers that are well-established and well-financed within their respective industries. Based on previous experience, the counterparties had zero default rates and management views this risk as minimal. Approximately 81% of accounts receivable are due from two customers at December 31, 2011 and all accounts receivable are current. These main customers present good credit quality and historically have a high quality credit rating.

CASH AND CASH EQUIVALENTS

The Company has cash and cash equivalents in the amount of \$592,259 at December 31, 2011 and mitigates its exposure to credit risk on its cash balances by maintaining its bank accounts with Canadian Chartered Banks and investing in low risk, high liquidity investments.

22. FINANCIAL INSTRUMENTS (CONTINUED)

The Company received \$750,000 under a capital expenditure grant agreement and has presented this amount as deferred revenue and considers it restricted cash as it can be spent only for qualified expenditures.

There are no past due or impaired financial assets. The maximum exposure to credit risk is the carrying amount of the Company's accounts receivable, cash and cash equivalents, and restricted cash and cash equivalents. The Company does not hold any collateral as security.

B) LIQUIDITY RISK

Liquidity risk relates to the risk that the Company will encounter difficulty in meeting its financial obligations. The long-term debt matures in January 2013. It is the intention of the Company that refinancing will be negotiated at that time should it be required. The Company may be exposed to liquidity risks if it is unable to collect its trade accounts receivable balances in a timely manner, which could in turn impact the Company's long-term ability to meet commitments under its current facilities. In order to manage this liquidity risk, the Company regularly reviews its aged accounts receivable listing to ensure prompt collections. The Company regularly reviews its cash availability and whenever conditions permit, the excess cash is deposited in short-term interest bearing instruments to generate revenue while maintaining liquidity. There is no assurance that the Company will obtain sufficient funding to execute its strategic business plan.

The following are the contractual maturities of the Company's financial liabilities and obligations.

	0 - 1 year \$	1 - 3 years \$	4 - 7 years \$	Total \$
Accounts payable and accrued liabilities	624,154	–	–	624,154
Long-term debt, including interest	208,613	1,006,951	–	1,215,564
Royalties interest payable	33,366	–	–	33,366
Royalty financial liability	74,057	189,566	–	263,623
Repayable research funding	52,133	32,500	–	84,633
Repayable CAAP funding	–	30,770	92,311	123,081
Total	992,323	1,259,787	92,311	2,344,421

C) MARKET RISK

Market risk is comprised of interest rate risk, foreign currency risk, and other price risk. The Company's exposure to market risk is as follows:

(1) FOREIGN CURRENCY RISK

Foreign currency risk arises from the fluctuations in foreign exchange rates and the degree of volatility of these rates relative to the Canadian dollar.

The following table summarizes the impact of a 1% change in the foreign exchange rates of the Canadian dollar against the US dollar (USD) on the financial assets and liabilities of the Company.

	CARRYING AMOUNT (USD)	FOREIGN EXCHANGE RISK (USD)	
		- 1% EARNINGS & EQUITY	+1% EARNINGS & EQUITY
Financial assets			
Accounts receivable	424,807	4,248	(4,248)
Financial Liabilities			
Accounts payable and accrued liabilities	177,783	(1,778)	1,778
Total increase (decrease)		2,470	(2,470)

The carrying amount of accounts receivable and accounts payable and accrued liabilities in USD represents the Company's exposure at December 31, 2011.

(2) INTEREST RATE RISK

The Company has minimal interest rate risk because its long-term debt is a fixed rate of 5.49%. However, in the event of a default, the rate would increase to 7.49% and result in an increase in the required monthly principal and interest payment by \$1,541.

Management believes that changes in interest rates will not have a material impact on the Company as the Company's long-term debt is due in January, 2013.

23. CAPITAL DISCLOSURES

The Company considers its capital to be its shareholder equity (deficiency). The Company's objective in managing capital is to ensure a sufficient liquidity position to finance its manufacturing operations, research and development activities, administration and marketing expenses, working capital and overall capital expenditures, including those associated with patents and trademarks. The Company makes every effort to manage its liquidity to minimize dilution to its shareholders when possible.

The Company has funded its activities through public offerings and private placements of common shares, royalty offerings, loans, convertible debentures, and grant contributions.

The Company is not subject to externally imposed capital requirements and the Company's overall strategy with respect to capital risk management remains unchanged from the year ended December 31, 2010.

24. GOVERNMENT ASSISTANCE

During the year ended December 31, 2010, the Company was approved for non-repayable funding in the amount of \$124,000 from Alberta Ingenuity. During 2011, the Company received \$62,000 (2010 – \$20,750) which was recorded as a reduction of research and product development expenses. The Company anticipates receiving an additional amount of \$41,250 in 2012 under this program.

The Company was approved for non-repayable funding for up to 50% of eligible costs to a maximum of \$99,900 under the Growing Forward Product Development program. The Company recognized \$60,076 during the year ended December 31, 2011 (2010 – \$39,824) as a reduction of research and product development expenses. This program has now been completed.

24. GOVERNMENT ASSISTANCE (CONTINUED)

The Company was approved for non-repayable funding in the amount of \$50,000 for eligible costs from the Atlantic Canada Opportunities Agency. The Company recognized \$10,879 during the year ended December 31, 2011 (2010 – \$39,121) as a reduction of research and product development expenses. This program has now been completed.

The Company was approved for non-repayable funding to a maximum of \$21,250 of eligible expenditures under the Novel Crops Initiative program from the Prince Edward Island Department of Agriculture. The Company recorded the amount of \$5,000 as a reduction of research and product development expenditures under this program in the year ended December 31, 2011 (2010 – \$5,925). The Company anticipates receiving an additional amount of \$5,000 in 2012 under this program.

The Company was approved for non-repayable funding of \$7,055 under the Growing Forward Lean Manufacturing Initiative. The Company recognized \$5,823 as a reduction of the cost of certain property and equipment, and \$1,232 as a reduction of research and development expenditures in the year ended December 31, 2010. The full amount of \$7,055 was included in accounts receivable at December 31, 2010 and received in the first quarter of 2011. This program has now been completed.

The Company received a repayable non-interest bearing contribution for research and development expenditures in the amount of \$50,000 in 2011 (2010 – \$50,000) from Innovation PEI which is recorded as a repayable research funding liability on the consolidated balance sheets less \$15,367 which was repaid. The contribution is repayable quarterly at a rate of one percent of sales revenue subject to a minimum payment of \$12,500 per quarter. The Company anticipates repayment of \$52,133 during the year ended December 31, 2012.

The Company was approved for non repayable grant funding from Innovation PEI for a maximum of \$100,000. During the year ended December 31, 2011, the Company received \$30,000, and recognized \$19,500 against eligible expenses and \$10,500 as deferred revenue. The Company anticipates an additional \$70,000 could be received in 2012.

The Company is eligible to claim up to \$1,339,625 of eligible research and development expenditures incurred in 2011 and 2012 under the Canadian Agricultural Adaptation Program. All amounts claimed under the program are repayable interest free over eight years beginning in 2013. The Company has received funding of \$123,081 to date under this program (note 13).

During the year ended December 31, 2011, the Company commenced a research and development project agreement. Under this project, the Company paid cash of \$56,177 in 2011, and will make an additional payment of \$28,236 in 2012. The other party to the research and development project agreement will make an in-kind contribution to the project of \$42,262.

During the year ended December 31, 2011, the Company entered into a Contribution Agreement with AI-Bio Solutions for a non-repayable grant contribution totaling up to \$1,600,000 towards the construction of a new bio-processing facility and subject to compliance with all terms and conditions of the agreement. In accordance with the agreement, the Company received \$750,000 in 2011 presently classified as restricted cash and cash equivalents, and anticipates additional amounts will be received as follows: \$650,000 in 2012, \$40,000 in 2013 and \$160,000 in 2014. It is anticipated that as these amounts are expended they will be recorded as a reduction of capital cost.

25. INCOME PER COMMON SHARE

	2011	2010
Net income for the year	\$577,573	\$463,722
Interest not incurred on convertible debentures if converted	–	41,096
Net income for the year for diluted income per share calculation	577,573	504,818
Weighted average number of shares outstanding	56,561,513	53,219,621
Potential shares to be issued for convertible debentures outstanding	–	5,000,000
Potential shares to be issued for options exercisable	78,621	–
Diluted shares outstanding	56,640,134	58,219,621
Income per share – basic	\$0.01	\$0.01
Income per share – diluted	\$0.01	\$0.01

Of the Company's 3,170,000 (2010 – 3,105,000) options outstanding, 2,600,000 (2010 – 3,105,000) stock options have not been included in the diluted income per share calculation for the year ended December 31, 2011 because the options' exercise prices were greater than the average market price of the common shares during the year.

26. SUBSEQUENT EVENTS

Subsequent to December 31, 2011, the Company and its wholly-owned subsidiary, Ceapro Technology Inc. were served with a statement of claim from AVAC Ltd. alleging damages of \$1,470,500 pursuant to two product development agreements. The Company and Ceapro Technology Inc., have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However, at this time, the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

III INVESTOR INFORMATION MAY 2012

DIRECTORS

Edward Taylor, Chairman
Gilles Gagnon, Acting CEO
Donald Oborowsky
Glenn Rourke
John Zupancic

OFFICERS

Branko Jankovic, CA
Chief Financial Officer

David Fielder, M. Sc.
Chief Scientific Officer

HEAD OFFICE

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STOCK INFORMATION

Listed on the TSX Venture Stock Exchange
Symbol: CZO

REGISTERED OFFICE

2600 Manulife Place
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TRANSFER AGENT & REGISTRAR

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2300 Palliser Square
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Calgary, AB T6G 0P6
Canada

CHANGE OF ADDRESS

Registered Shareholders should notify the Company's Transfer Agent and Registrar at the address set out above.

Beneficial Owners should contact their respective brokerage firm to give notice of change of address.

FINANCIAL CALENDAR

The Company's year-end is December 31. Quarterly reports are mailed in May, August, and November.

ANNUAL GENERAL AND SPECIAL MEETING OF SHAREHOLDERS

The annual general and special meeting of shareholders will be held on:

June 26, 2012 at 10am MDT

Location:
4th floor Enterprise Square
10230 Jasper Avenue
Edmonton Alberta T5J 4P6

EQUAL OPPORTUNITY EMPLOYER

Ceapro Inc. is an equal opportunity employer and seeks to attract and retain the best-qualified people regardless of race, religion, national origin, gender, sexual orientation, age, or disability.



Ceapro Inc.

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